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THESIS

THE TREND TOWARD FREE TRADE AREAS:
ECONOMIC CONSEQUENCES AND
POLICY IMPLICATIONS FOR THE UNITED STATES

by

William H. All IV

December, 1992

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93-05775



UNCLASSIFIED

SECURITY CLASSIFICATION OF THIS PAGE

REPORT DOCUMENTATION PAGE

Form Approved
OMB No. 0704-0188

1a. REPORT SECURITY CLASSIFICATION UNCLASSIFIED			1b. RESTRICTIVE MARKINGS		
2a. SECURITY CLASSIFICATION AUTHORITY			3. DISTRIBUTION/AVAILABILITY OF REPORT Approved for public release; distribution is unlimited.		
2b. DECLASSIFICATION/DOWNGRADING SCHEDULE					
4. PERFORMING ORGANIZATION REPORT NUMBER(S)			5. MONITORING ORGANIZATION REPORT NUMBER(S)		
6a. NAME OF PERFORMING ORGANIZATION Naval Postgraduate School		6b. OFFICE SYMBOL (If applicable) NPS/NS	7a. NAME OF MONITORING ORGANIZATION Naval Postgraduate School		
6c. ADDRESS (City, State, and ZIP Code) Monterey, California 93943-5000			7b. ADDRESS (City, State, and ZIP Code) Monterey, California 93943-5000		
8a. NAME OF FUNDING/SPONSORING ORGANIZATION		8b. OFFICE SYMBOL (If applicable)	9. PROCUREMENT INSTRUMENT IDENTIFICATION NUMBER		
8c. ADDRESS (City, State, and ZIP Code)			10. SOURCE OF FUNDING NUMBERS		
			PROGRAM ELEMENT NO.	PROJECT NO.	TASK NO. WORK UNIT ACCESSION NO.
11. TITLE (Include Security Classification) THE TREND TOWARD FREE TRADE AREAS: ECONOMIC CONSEQUENCES AND POLICY IMPLICATIONS FOR THE UNITED STATES (Unclassified)					
12. PERSONAL AUTHOR(S) All, William H., IV					
13a. TYPE OF REPORT Master's Thesis		13b. TIME COVERED FROM ____ TO ____		14. DATE OF REPORT (Yr., Mo., Day) 1992, December	
15. PAGE COUNT 150					
16. SUPPLEMENTARY NOTATION: The views expressed in this thesis are those of the author and do not reflect the official policy or position of the Department of Defense or the U.S. Government.					
17. COSATI CODES			18. SUBJECT TERMS (Continue on reverse if necessary and identify by block number)		
FIELD	GROUP	SUB-GROUP	U.S. Economic Policy, U.S. Trade Policy General Agreement on Tariffs and Trade, Free Trade Areas, Free Trade Agreements, Economic Blocs, Economic Regionalism, Customs Unions		
19. ABSTRACT (Continue on reverse if necessary and identify by block number) Because America's economy relies to a significant degree on export markets and external sources of raw materials, the health of the international trading system is critical to the national security of the United States. This thesis demonstrates that the organization on which America has relied for the functioning of the international trading system since the 1950s, the General Agreement on Tariffs and Trade (GATT), has become increasingly difficult to sustain. It is argued that a replacement of that institution is a more effective global trading structure based on a triad of large regional free trade areas (FTAs) and bilateral agreements. Using the generally accepted tenets of customs union theory, that the impact on the United States of such a triad could be generally positive in the absence of a functioning GATT. Based on this evidence, American trade policy guidelines are proposed to maximize American advantage in the evolving system.					
20. DISTRIBUTION/AVAILABILITY OF ABSTRACT [XX] UNCLASSIFIED/UNLIMITED [] SAME AS RPT. [] DTIC USERS			21. ABSTRACT SECURITY CLASSIFICATION Unclassified		
22a. NAME OF RESPONSIBLE INDIVIDUAL Robert E. Looney			22b. TELEPHONE (Include Area Code) (408) 646-2228		22c. OFFICE SYMBOL NS/Lx

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CONSEQUENCES AND POLICY IMPLICATIONS FOR THE UNITED STATES

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Lieutenant, United States Navy
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Submitted in partial fulfillment of the
requirements for the degree of

MASTER OF ARTS IN NATIONAL SECURITY AFFAIRS
STRATEGIC PLANNING

from the

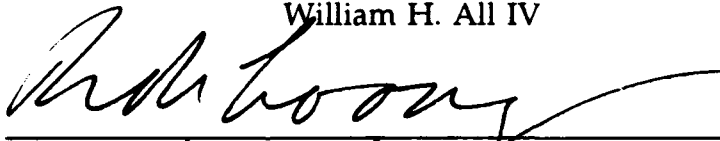
NAVAL POSTGRADUATE SCHOOL
December, 1992

Author:

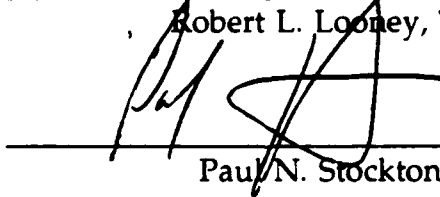


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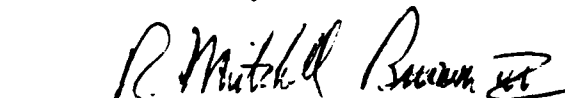
Approved by:



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Department of National Security Affairs

ABSTRACT

Because America's economy relies to a significant degree on export markets and external sources of raw materials, the health of the international trading system is critical to the national security of the United States. This thesis demonstrates that the organization on which America has relied for the management of the international trading system since the 1950s, the General Agreement on Tariffs and Trade (GATT), is failing to effectively fulfill its role of international trade regulation. It is argued that because of that failure, an alternative global trading structure based on a triad of large regional free trade areas (FTAs) is developing. It is proven, using the generally accepted tenets of customs union theory, that the impact on the United States of such a triad could be generally positive in the absence of a functioning GATT. Based on this economic analysis, broad American trade policy guidelines are proposed to maximize American advantage in the evolving system.

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DTIC	TAB <input type="checkbox"/>
Unannounced <input type="checkbox"/>	
Justification	
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Distribution /	
Availability Codes	
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A-1	

TABLE OF CONTENTS

I. INTRODUCTION	1
A. ALTERNATIVE SCENARIOS	4
II. GATT	11
A. FACTORS AFFECTING GATT FORMATION	11
B. THE GATT AGREEMENT	15
C. GATT ORGANIZATIONAL STRUCTURE	17
D. FACTORS INFLUENCING NATIONAL AFFILIATION	18
E. GATT POLICYMAKING PROCESS 1948-1979	23
F. URUGUAY ROUND PRELIMINARIES	25
G. THE URUGUAY ROUND	26
H. SPECIFIC ISSUE AREAS	29
I. FUTURE PROBLEM AREAS	32
III. A GATT ALTERNATIVE: REGIONAL FREE TRADE AREAS	36
A. THE EUROPEAN COMMUNITY	37
1. EC Development and Current Status	37
2. EC Futures	44
B. THE NORTH AMERICAN FREE TRADE AREA	47
1. The U.S.-Mexico Relationship	48

2. The U.S.-Canada Relationship	50
3. Potential NAFTA Structure, Benefits, and Prospects	53
C. THE ASIAN FREE TRADE AREA	60
1. ASEAN Development	63
2. ASEAN Today	66
3. The Role of Japan	69
4. AFTA Futures	72
IV. POTENTIAL ECONOMIC EFFECTS OF TRADING BLOCS	74
A. TRADITIONAL GAINS FROM INTERNATIONAL TRADE	75
B. CUSTOMS UNION THEORY-STATIC EFFECTS AND THE GLOBAL TRIAD	77
C. DYNAMIC EFFECTS AND THE GLOBAL TRIAD	87
D. OTHER EFFECTS AND THE GLOBAL TRIAD	89
E. SUMMARY OF FTA ECONOMIC EFFECTS	94
V. CONCLUSIONS AND POLICY RECOMMENDATIONS	95
A. CONCLUSIONS	95
B. POLICY RECOMMENDATIONS	98
ENDNOTES	104
APPENDIX A: GATT ROUNDS SINCE WWII	128
APPENDIX B: GATT STRUCTURE	129
APPENDIX C: GATT SUB-BODIES	131
APPENDIX D: EC MEMBERSHIP	132

APPENDIX E: MECHANICS OF THE U.S.-CANADA FREE TRADE AGREEMENT	133
APPENDIX F: THE NATIONAL OBJECTIVES OF THE FUTURE MEMBER STATES	135
APPENDIX G: WORLD TRADE FLOWS	137
INITIAL DISTRIBUTION LIST	138

EXECUTIVE SUMMARY

With East-West political tensions reduced and ideologically based political relationships in decline, America's international economic relationships are now substantially more important than they have been in the past. Unfortunately, in today's changing world the international economy seems to be increasingly adrift as historically important trading associations fail and new ones are created.

Some analysts have cautioned that recent international trends toward the development of regional economic relationships known as Free Trade Areas (FTAs) will inevitably lead to the formation of economic trading blocs and a new era of hostility in the global economic environment. These same analysts often predict that FTA creation may well presage so-called trade wars or, at the extreme, the possibility of armed conflict.

Clearly, the developing relationships characterized as FTAs must be handled properly. FTA development and potential economic consequences thus lead American policy considerations today. American foreign policymakers must correctly address these evolving international economic relationships to ensure continued U.S. economic vitality. This thesis is intended to assist in the resolution of the current American policy dilemma concerning the future of Free Trade Areas. To that end, issues relating to the apparent failure of the General Agreement on Tariffs and Trade (GATT) to resolve long standing restrictive trade

practices and growing trends in the global economy toward the pursuit of economic interests within a regional framework of free trade agreements are addressed. Initially, the GATT is explored to conclude that the organization's future as a forum for the management of international trade is not bright. It is demonstrated that GATT's future is limited due to the presence of particularly divisive issues in the ongoing Uruguay Round of trade negotiations and, more importantly, significant long-term structural shortcomings.

Because GATT may not provide sufficient structure for the management of global trading relationships, current international trends toward the development of regional economic associations based on FTAs are considered. It is specifically argued that, at present, three major regional organizations show potential for further development, the European Community (EC), the North American Free Trade Area (NAFTA), and the Association of South East Asian Nations (ASEAN). It is further argued that these regional economic groupings will probably form an economic triad capable of controlling a large portion of future international trade. To illustrate these areas' potential economic influence, their development and current characteristics are briefly profiled.

In the pivotal section of this thesis, the economic theories associated with customs unions analysis are used to investigate the potential economic effects of the above triad-based global economic structure with emphasis on its effect on the economy of the United States. I argue that a triad based system of FTAs will not, as some analysts have suggested, necessarily have negative economic

consequences for this country. Such a system, in the absence of a viable GATT structure, may in fact, hold economic benefits for the U.S if properly constructed. Of equal significance, such a triad could lead to greater international cooperation under the auspices of GATT in the future.

In conclusion, broad U.S. economic policy objectives that are intended to maximize American advantage under a developing FTA system are offered. The conscious pursuit by America of a dual track approach toward international trade relationships is recommended. It is argued that the first track should be based on the revitalization of the GATT process, with a goal of expanding, and "re-institutionalizing" that international trade organization, allowing it to adapt to a more regional perspective. A second, related track should emphasize the acceptance and encouragement of a regional approach to trade liberalization by the United States. It is argued that such an approach would preserve American advantage in the existing trading system while laying a solid foundation for future American economic success.

I. INTRODUCTION

The end of the "Cold War" between the United States and the Soviet Union has forced the world to move beyond bipolar structures to a more multipolar system. More importantly, it has spurred consideration of non-military issues by international actors. Economic concerns have replaced military concerns in international political relationships. Central among these issues are those concerning international trade relations, trade alliances, and the global economy.

In the over 40 years since World War II, world trade has expanded from approximately \$60 billion to \$4 trillion U.S. dollars and continues to grow.¹ Also, more countries are involved in international trade relationships than ever before. Growth in international trade has increased levels of regional interdependence as other nations, both newly industrialized and developing, forge or renew trade relationships. It has also strained existing trade relationships. Current trade infrastructure, based on the General Agreement on Tariffs and Trade (GATT), was clearly not designed to handle the resulting trade problems.²

Exacerbating the crisis in the GATT is the fact that America, though still the world's largest trading nation (accounting for about 12 percent of all international trade), is no longer the economic giant that dominated the world at the close of World War II.³ The U.S. is no longer capable, therefore, of dominating GATT negotiations and policies as it has at times in the past.

Realistically the U.S. may only be capable of limited leadership in the modern global economic system. It seems to many that, lacking leadership, the world trading structure is increasingly drifting into a structure defined by regional units.⁴ This new system poses two questions for American policymakers. First, how will developing regional economic relationships affect the U.S. economy? Second, what is the appropriate U.S. policy response in a world where the influence and credibility of GATT is waning?

This thesis proposes to aid in the ongoing policymaking process by answering the above questions and by determining the appropriate American trade policy orientation in a regionally structured trading system. To that end, it will initially prove:

- First, that the GATT system of trade regulation is failing to provide the infrastructure necessary to fully regulate world trade. Failure of GATT will lead to a revolution in trade relations.⁵
- Second, the most likely alternative for the resulting global trading system is a structure based upon certain major customs unions or regional free trade areas (FTAs).⁶

Three FTAs, the European Community (EC), the proposed North American Free Trade Area (NAFTA), and the Association of South East Asian Nations (ASEAN) are more likely to exert major influence on the global trading system than others.⁷ These major regional trading units will thus be briefly examined later in the thesis to summarize their possible development profile and chief characteristics. However, a quick initial look at these nation's Gross Domestic

Product (GDP) figures, as compared to the rest of the world (ROW), will illustrate how much influence these regions now have on the world economy and thus how powerful such a system could be (Table I).

TABLE I.

AREA	GDP TOTAL IN MILLIONS OF DOLLARS
EC	4,145,000
NAFTA	5,914,266
AFTA*	3,567,413
TOTAL	13,626,679
ROW	6,836,264

* including Japan and the Asian NIEs.

Sources: *International Marketing Data and Statistics* 1992, 16th edition (London: Euromonitor, 1992).

Although the formation of these three unions cannot be taken for granted, the evidence presented will make it clear that the predicted outcomes are likely enough to be reflected in U.S. policy considerations.⁸

Based on the evidence presented above concerning the future of the international economy, the central hypothesis of this paper will be discussed.⁹ It will be proven that:

- The growth of regional trading blocs, within specific boundaries, will have minimal, if any, negative economic effects on the American economy as long as they are subject to basic GATT requirements concerning customs unions. They may, in fact, provide an alternative path to greater global trade freedom.

Due to their minimal potential economic effects, regional trade agreements, subject to the requirements of the GATT, should not be discouraged by U.S. policymakers. A trade policy orientation encouraging the formation of regional free trade areas, combined with continued efforts to expand GATT, should allow America to reap maximum gains from the evolving system.

A. ALTERNATIVE SCENARIOS

What defines an FTA? Noted economist Jeffrey J. Schott has proposed that FTAs:

...eliminate barriers to trade at the border between the partner countries. Unlike customs unions, however, each country maintains its own restrictions against trade from third countries. As a result, FTA partner countries receive preferential access to each other's markets at the expense of nonmembers.¹⁰

Certainly FTAs discriminate externally against nonmembers. However, so do individual national actors. Discrimination in external trade is no more a characteristic of an FTA than it is a characteristic of any other national actor. What Dr. Schott is emphasizing is the fact that an FTA, unlike a customs union, retains a certain element of control over its external policy while conforming to FTA rules in its internal relations. Economist Ali M. El-Agraa confirms this definition, emphasizing:

...member nations remove all trade impediments among themselves but retain their freedom with regard to the determination of their policies *vis-a-vis* the outside world...¹¹

Thus, for the purposes of this thesis, an FTA will be defined simply as a group of independent national actors who eliminate all (or a portion) of trade barriers between themselves by means of a formal treaty while preserving the right to independent action in external relations. No preconceived notions as to the nature of external relations will be included.¹²

Evolution into a structure based on regional FTAs is a plausible future for international trading system. In fact, in the U.S., over 88 percent of business executives believe that the world economy is shifting toward a more regional, trading bloc orientation.¹³ Many economists, trade analysts, and political leaders agree.¹⁴ Nevertheless, on the topic of regionalism's effects, like many other economic issues, opinions are widely divergent. Those who applaud the evolution of the international system into such a form often base their views on the perceived benefits of such a system (Table II). Conversely, those who oppose an FTA structure sometimes base their views on an FTA structure's perceived negative effects (Table III).

TABLE II.

POSSIBLE BENEFITS OF FTAs
<ul style="list-style-type: none">• MORE EASILY TAILORED TO SPECIFIC CIRCUMSTANCES• ALLOW MORE RAPID LIBERALIZATION THAN GATT BECAUSE OF COMPLIMENTARY OBJECTIVES-ELIMINATES:<ol style="list-style-type: none">1. FOOT DRAGGERS-MEMBERS TAKING ADVANTAGE OF CONSENSUS RULES TO BLOCK PROGRESS UNTIL THEIR DEMANDS ARE MET2. CONVOY EFFECTS-LEAST WILLING PARTICIPANT DETERMINES THE PACE OF NEGOTIATIONS3. FREE RIDERS-MEMBERS ENJOYING MFN PRIVILEGES WHILE ESCAPING OBLIGATIONS• CONTRIBUTES TO EVOLUTION OF GATT (PARTICULARLY DISPUTE SETTLEMENT PROCEDURES• PROMOTES PROGRESS IN AREAS NOT COVERED BY GATT• MAY LIMIT THE NUMBER OF NEGOTIATING PARTNERS IN GATT• GREATER LIKELIHOOD OF POSITIVE OUTCOME BECAUSE NEGOTIATIONS LIMITED-ISSUES AND PARTIES• RAPID PACE CREATES INCENTIVE FOR FURTHER REFORM, FUTURE AGREEMENTS• MORE COMPREHENSIVE AGREEMENTS LIKELY• CREATES BILATERAL CONFIDENCE THAT MAY LEAD TO MULTILATERAL PROGRESS• DIRECTS ATTENTION TO NEW AND IMPORTANT TRADING PARTNERS• REDUCES BILATERAL TRADE BALANCES• CREATES TRADE BY REDUCING INTERNATIONAL BARRIERS• PRESERVES AND EXPANDS MARKET ACCESS• IMPROVES POLITICAL AND SECURITY RELATIONSHIPS• PROMOTES SOCIAL STABILITY AMONG POORER PARTNERS• PROVIDES A VEHICLE TO CHALLENGE PROTECTIONISM IN OTHER BLOCS

TABLE III.

POSSIBLE COSTS OF FTAs	
<ul style="list-style-type: none">• DIMINISHMENT OF MFN AND GATT GAINS• DETRACTS FROM FOCUS ON URUGUAY ROUND• UNLIKELY TO ADDRESS BILATERAL IMBALANCES• POTENTIAL SOVEREIGNTY LOSSES• IF FTA GOALS NOT ACHIEVED THEN BILATERAL RELATIONS MIGHT WORSEN• WITH MULTIPLE FTAs:<ol style="list-style-type: none">1. CREATION OF RULE OF ORIGIN PROBLEMS2. SEQUENCING OF FTAs A PROBLEM3. OLD PARTNER RESENTMENT OF NEW PARTNER BETTER DEAL COULD CAUSE TENSION	

As an international system based on FTAs evolved, both positive and negative scenarios can be imagined. FTAs might increase overall economic efficiency. They might result in trade growth and the creation of needed consensus capable of promoting the further reduction of international trade barriers. If so, they could be integrated into some type of world trading system. Proponents of this plausible future would assume the creation of a World Trading Organization (WTO) or some other similar structure to provide the structure that the GATT cannot. Presumably, since the United States has long been an advocate of world free trade, such an outcome would be perceived as beneficial to the U.S. economy. Carried to its logical extreme, this alternative might envision the complete integration of the international economy under some type of all-inclusive global economic structure.

Alternatively, the opposing perspective would be a retreat of the global trading system to an isolationist structure, similar in some ways to that of the 1930s. Based on hostile FTA regionalism instead of nationalism, such a system would engage in competitive and highly discriminatory trade practices that could result in the disintegration of the global trading system, distortion of world markets, world-wide depression, and ultimately war between polarized blocs. This, a doomsayer's perspective, could envision a world that failed to learn any lessons from the protectionist structure of the 1930s rushing headlong to its own destruction. Obviously, no nation would benefit from this outcome.

A review of the existing literature indicates that trade and policy experts have mixed views on the development of a trading bloc system. These views range from support of FTAs as trade expanding and growth promoting to insistence that regional blocs will lead only to increased protectionism and possible future trade wars.

Richard Tropp, a trade analyst with the Washington Capital Development Corporation, has argued that regional trading blocs should be used "rationally" to help developing countries expand external markets. He further states that "...these trading agreements present opportunities for, vice barriers to, U.S. business."¹⁵ Rudiger Dornbusch of Massachusetts Institute of Technology also takes the positive view. He has argued that regionalism offers the opportunity for more trade within the region and "...need not cause trade wars between competing blocks (sic)."¹⁶ Finally, Peter Morici, of the University of Maine states

that regional agreements will "...provide some of the benefits of multilateral liberalization with more predictable and controllable adjustment costs."¹⁷

Jagdish Bhagwati, who is often described as the leading academic opponent of regional agreements, has argued that FTAs send signals of protectionism and undermine the GATT process. For these reasons, if no other, he believes they are a detriment to the global trading system.¹⁸

Michael Aho and Johnathan David Aronson, trade experts who have written extensively on the future of the GATT, take a more extreme view. They have discussed the scenario of trading bloc wars, saying:

The danger is that if progress in GATT slows or evaporates altogether while regional trade bargains proceed, the world trade system could end up being divided into blocs, each surrounded by walls of trade barriers. The benefits of global trade could be lost. Business investment made on the basis of world markets would be frustrated. Economies of large scale would be sacrificed. And what remains of GATT discipline and principles could collapse. Interregional or global trade wars could take place, with devastating impact on many economies and on global economic cooperation.¹⁹

Aho and Aronson's judgement regarding trading blocs leaves no doubt that they would prefer to maintain the status quo of GATT rather than continue any evolution toward a system of regional FTAs. This scenario, in its extreme formulation, could lead not only to economic "warfare" but to military confrontation as well.

Is this dismal forecast accurate? Is the GATT system failing and leading to inevitable regional trade wars? The continued viability of the GATT will

obviously be an initial determinant of the future of the world trading system. The future of the GATT is thus an appropriate topic for initial examination.

II. GATT

Recently, debate on changing global economic relationships has centered on the future of the General Agreement on Tariffs and Trade (GATT). Specifically, the continuing stalemate in the Uruguay Round of GATT negotiations has clouded the future of this trade management organization.

This chapter proposes to examine the status of the GATT. By describing the factors affecting the formation of the organization, its fundamental features, its infrastructure, and its policy-making process, the evolution of GATT will be explored. Additionally, the potential for a successful conclusion to the ongoing Uruguay Round of negotiations will be examined. Thoughtful consideration of these issues will demonstrate that, even if agreement is reached, the Uruguay Round is unlikely to generate either international consensus or American satisfaction. Lack of a satisfactory outcome may lead to the growth of alternative trade management structures in the form of regional trade agreements.

A. FACTORS AFFECTING GATT FORMATION

GATT has its roots in the problems created by the "Great Depression" of the 1930s. Prior to this period, the United States (and other countries) sought to promote their industries by protecting them against the dominant, historically free-trade oriented British industrial machine.²⁰

By the late 1920s and early 1930s, with international economic problems mounting, protectionism was on the increase. Bilateral agreements and nationalist sentiments began to dominate the international trading system. The extensively protectionist Smoot-Hawley Tariff Act, passed by the U.S. Congress in 1930, helped spur world-wide declines in trade, massive job losses, declining industrial output, and a worsening international financial crisis.²¹ Other countries institutionalized protectionist barriers such as high tariffs, import/export quotas, exchange controls, defensive economic alliances, and industrial subsidization in retaliation for American actions.²² As a result, world trade fell by two-thirds between 1929 and 1933.²³ U.S. exports plunged as well. The economic nationalism that emerged almost certainly contributed to the beginning of the depression. Fortunately, landmark American legislation in the form of the 1934 Reciprocal Trade Agreements Act led the road to improved relations. Within ten years, the U.S. had formed bilateral agreements with 27 countries.²⁴

At the close of WW II, it became clear to many that protectionist measures were in danger of becoming permanent unless pre-depression multi-lateral trade patterns were reestablished.²⁵ With that realization, and the essential encouragement of the United States and Britain, general international consensus was established to attempt an agreement limiting protectionism.

Momentum gained from the approval of the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (or World Bank) led the U.S. to propose negotiations toward a "Havana Charter." The

charter was intended to provide for the formation of an international trade management organization.²⁶ The resulting International Trade Organization (ITO) proposal was hoped to provide a "multi-lateral framework for international economic relations."²⁷ GATT, proposed virtually simultaneously, was intended only as an "temporary" organization to oversee international trade until the proposed ITO was approved by Havana negotiators and ratified by its signatories.

GATT negotiations began in Geneva on 10 April 1947 with several primary goals. A primary objective of the conferees was to concentrate on the "substantial reductions of tariffs and other trade barriers and to the elimination of preferences on a reciprocal and mutually advantageous basis."²⁸ Another primary goal, however, was to "draft a charter" for upcoming ITO negotiations in Havana.²⁹ Both objectives were accomplished. Agreement on the GATT was concluded on 30 October 1947 and signed by 23 nation-states at the United Nations Conference on Trade and Employment.

The proposed charter for an ITO was forwarded to Havana where negotiations began on 21 November 1947 and concluded successfully on 24 March 1948.³⁰ Unfortunately however, successful conclusion of the negotiations did not ensure ITO ratification. The United States (and several other countries) balked at joining the comprehensive structure created by the ITO, preferring instead to make permanent the less restrictive objectives of the GATT.³¹

GATT, the international organization that is the center of modern international trade relations, was actually implemented in January 1948. Since that

time it has sought to live up to goals identified in its founding document's preamble, advocating:

Relations in the field of trade and economic endeavor should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, developing the full use of the resources of the world and expanding production and the exchange of goods; being desirous of contributing to these objectives by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce...³²

Carefully attempting to balance the above goals in an effort to create economic efficiency, while minimizing distortions of member nation sovereignty, has been the fundamental aim of the GATT.

Proponents who believe the GATT has met its stated ideals cite its vastly expanded membership and the growth in world trade under GATT auspices to illustrate its success. Their claims are not without merit. GATT's first round led to commitments to "bind or lower" 45,000 separate tariff restrictions.³³ Also, from an initial membership of 23 nations in 1948, the GATT, by June of 1992, had 108 full members (including over 75 developing countries) and many others either requesting membership or identified as associate members. Further, GATT members now account for 80 percent of world trade.³⁴ Through seven rounds of multilateral negotiations, excluding the currently stagnated Uruguay Round, the GATT retained the initiative in promoting the growth of world trade and multilateralism (Appendix A).

B. THE GATT AGREEMENT

The GATT agreement is composed of 34 articles, 15 of which define the agreements essential characteristics. Article 1, often cited as the central feature of the agreement, establishes most-favored nation (MFN) treatment in tariffs among all member nations.³⁵ MFN status is designed to lead to overall trade liberalization and minimization of the market distortions associated with state protectionism. These goals are intended to be achieved through the removal of quotas, reduction of tariffs, and reduction of barriers to trade in goods via reciprocal trading agreements. Article 2 contains basic tariff concession schedules resulting from the conference. Article 3 provides rules for the assessment of internal taxes. Articles 4 to 10 address technical aspects of trade (including anti-dumping measures in Article 6) and articles 11 to 15 deal with quantitative restrictions (quotas). The remaining articles deal primarily with administrative/technical aspects of the agreement such as treaty exceptions, alternative structures, and violation procedures.³⁶

Most important (and currently most controversial) of the last 19 articles is Article 24, which covers, among other issues, the creation of customs unions. Though the agreement requires that such unions conform to GATT principles, this article effectively modifies Article 1 to allow the creation of Free Trade Areas (FTAs). Thus, even though it is generally accepted that external discrimination in a free trade area (FTA) is inherent, they are legal under the GATT.³⁷

Article 24 requires that GATT be notified of the FTA's existence (part 3a), that the FTA cover all merchandise trade between participating nations (part 4), and that the FTA must not be formed to raise trade barriers to nations outside the area (part 4). Despite the fact that GATT has considered at least 69 FTA and preferential trade agreements since its inception, these requirements have rarely been met in practice. Most of the above edicts, particularly those concerning external barriers, have been obviously violated in principle (and in practice) by existing FTAs. This is, at least in part, because of the early American endorsement of the formation of the EC. Though American policymakers expected the EC to violate Article 24, its potential political benefits were, at the time, expected to outweigh the potential negative trade effects.

Still, despite the failure of GATT to enforce the requirements of article 24, experts feel that the organization has been relatively successful in addressing many trade issues. Its success has been in its ability to deal with issues that are "...clearly defined and that are perceived as serious by the most influential contracting countries."³⁸

There are, however, certain areas associated with international trade that GATT does not address. The organization does not directly consider the intangible benefits of trade (such as the social relationships produced by trade), nor does it consider the associated social costs (such as minimum wages or child labor laws).³⁹ Its sole purpose is to further trade freedom.

C. GATT ORGANIZATIONAL STRUCTURE

The organizational structure that has given GATT its success in the past is relatively similar to other international organizations under the umbrella of the United Nations. It is composed of a Secretariat, a Council of Representatives, and the general membership (see Appendix B for a more complete description of these bodies). Sub-groups (committees and councils), meet as required under the auspices of the central organs (Appendix C). Both the Secretariat and the membership normally meet annually while the Council meets as needed to handle business between sessions.⁴⁰ Members of GATT contribute to the organization based on the level of participation in the total trade between contracting parties and their associated governments. As in many other UN organizations, agreements under GATT auspices are included in protocols (approved essentially by consensus) which must then be ratified by member states.

The above organization has been an effective forum for trade discussions for many years. However, the effectiveness of the GATT has not been due so much to any uniqueness of structure as it is to continued active member participation. To understand the reasons nations have and continue to maintain active GATT membership it is important to understand their goals in affiliation. To that subject we now turn.

D. FACTORS INFLUENCING NATIONAL AFFILIATION

Members of GATT have joined the organization for a multitude of different reasons. This sub-section specifically explores three categories of international actors' motivations for seeking and continuing membership in the GATT. First, Europe, America, and Japan will be examined as representative of the industrialized participation in the agreement. Though not an inclusive sample, it is probable that this group represents the general universe of membership goals of much of the democratic, industrialized world. Two other general groupings will also be examined, developing countries and those with centrally planned economies. These major structural groups, though again not all sharing exactly the same specific motivators toward GATT, nevertheless share enough general characteristics to be evaluated as a group.

The United States, along with the European Community (EC), and Japan have, since WW II, been considered, the three industrial pillars of the world trading system. These nations reasons for participating in GATT are generally based in desires to maintain influence over the functioning of the international trading system.

For the U.S., the organization has been a vehicle for espousing a stated national free-trade policy. Nevertheless, despite its public support of laissez-faire practices, the U.S. has, at times, used GATT principles to promote the protection of its own industries.⁴¹ More fundamentally, GATT has allowed the U.S. relatively unrestricted access to international markets while providing an effective

forum for the influencing of other nation's economies (on the strength of post-WW II American economic supremacy). Access and influence remain the primary reason for American participation.

The ability of the U.S. to influence other economies through GATT because of its post-WW II dominance has been a mixed blessing. Because of that dominance, the U.S. has been pressured by other members to accept a large number of unfavorable concessions. In fact, according to Clyde Prestowitz of the Economic Strategy Institute, the United States has traditionally given more concessions than it has received.⁴² For this reason, and others, American business, government and labor leaders are increasingly viewing GATT as a "very weak system" that is slow to enforce trading rules.⁴³ As a result, the attitudes toward current levels of American participation in GATT are clearly undergoing change.

First priorities for American negotiators in the current round include rules limiting subsidies, the protection of intellectual property rights, rules on investment, and rules protecting trade in services. Though membership continues to be seen by American decisionmakers as generally beneficial, future participation depends largely on the successful completion of negotiation on the above (and other) issues during the ongoing Uruguay Round.

For Western Europe, generally considered to be represented today by the European Community (EC), membership in GATT has also provided access and influence in the international trading system. Additionally, since the Kennedy

Round of GATT negotiation in the 1960s, the organization has been a vehicle for the protection of European self-sufficiency in agricultural production.⁴⁴ This issue continues to be the most controversial of ongoing Uruguay Round negotiations.

According to some experts, many in Europe see participation in GATT negotiations as "...a way of bringing external pressure to bear on the Community and the individual (EC) members to liberalize and reform some of the practices that are retarding its economic performance."⁴⁵ Thus, EC participation in GATT may have been not only to ensure international influence on trade issues but also to promote more narrowly focused regional interests as well.

Japan's propensities for GATT participation mirror those of the U.S. and the EC with very minor differences. Though sectors protected and trade goals differ from those pursued by the EC and U.S., Japan's reasons for participation in GATT remain fundamentally anchored in the desire to maintain both the access and the influence displayed by the other "pillars" of the world trading system.

According to Asian specialist Andrew Elek, "GATT has made it possible for Japan and other Western Pacific economies to exploit their comparative advantage."⁴⁶ GATT participation has allowed Japan and certain other newly industrialized Asian countries to pursue trade essential to their post-WW II economic growth, invest in other nations with only limited restrictions, and protect their own influential agricultural base without facing trade-restricting tariff and quota restrictions from their trading partners. Further, because "Japan finds it easier to bow to multi-lateral pressure, such as that from GATT, than to

bilateral demands from its major trading partners" the organization provides a valuable mechanism for the use of Japanese officials if accommodation is desired in trade disputes.⁴⁷

Developing countries reasons for participation in the GATT often vary from nation to nation and region to region depending on levels of industrialization and international socialization. Despite such variance, common themes emerge. Participation for these nations is vital because "the sectors in which they have comparative advantage according to the traditional factor endowment theory of trade—land and labor intensive products—are the most protected."⁴⁸ Special regimes in many wealthier, industrialized countries govern trade in agriculture, textiles/apparel, and steel. Ensuring access to these markets, is, for developing countries, essential to continued growth. Thus, as a group, developing nations often have the most to gain from an efficiently functioning, free-trade oriented GATT.

In spite of the potential positive benefits of GATT developing nations ability to participate fully in the agreement is often constrained by several factors.⁴⁹ First, many of these countries feel they are forced to actively promote exports while simultaneously erecting barriers to imports. This creates hostility among the more developed countries trying to promote their own products in the international marketplace. Second, often developing nations are "more comfortable" negotiating bilateral trade agreements with key trading partners instead of participating in more multi-lateral negotiations. Such attitudes make

progress in international forums difficult. Third, these nations, at times tend to favor national interests (for obvious reasons) over group discipline. This tendency often leads to inaction on GATT issues.

In the context of current negotiations developing countries will be seeking to preserve preferential treatment in market access (tariff reductions below those required by MFN) previously granted by developed countries. They will also seek to force greater adherence to GATT rules by industrial countries while avoiding the imposition of new rules restricting their own protective trade practices. Finally, many will seek, on an individual level, to preserve their privileged status as a developing country as their Gross National Products (GNPs) rise to levels approaching those of smaller industrialized countries.

Other potential and current members of GATT may fit somewhere in between developing and industrialized country parameters. These actors include primarily the communist and emerging formerly communist countries of China, Eastern Europe and the former Soviet Union.⁵⁰ Several theories seek to explain these nation's desire for membership.⁵¹ A first theory, known as the realist view, explains desires for association with GATT in terms of the political and security enhancements gained through internationally visible membership. A second theory, that of mercantilism, explains desires for membership by drawing heavily on the realist view. However, instead of focusing on the political/security advantages of GATT membership, the mercantilist theory focuses on the economic gains realized by participation. Regime theory, a final explanation, emphasizes the

desire to maintain international prestige through the support of the status quo in existing international regimes.

Such theories seem to explain at least part of the motivations behind these nations participation in GATT. However, more extensive research will be required as new relationships mature in these countries to fully understand their desires for membership.

Disparities in goals for the GATT between developing countries and major industrial countries remain widely divergent depending on factors too extensive to fully evaluate here. It is clear, however, that such differences have, and will continue to, greatly affect the future of the GATT as an international organization. In order to understand how that future may develop, we will next consider the organization's historical decisionmaking process.

E. GATT POLICYMAKING PROCESS 1948-1979

Formal GATT negotiations began with the 1947 discussions in Geneva. These rounds, and the five that followed from 1949 to 1962, were almost exclusively focused on tariff reduction issues. As a direct result of these successful negotiations, tariffs were reduced substantially from post WW II levels and most non-agricultural quotas were eliminated.⁵² Notably, however, each set of negotiations took increasing time to reach agreement. Both growing membership and increasingly divisive issues may have been at the root of the increase. Other highlights of these rounds included, "temporary" exceptions granted to agriculture

(1955) and the textile trade (1961) that were later institutionalized.⁵³ Not surprisingly, these exemptions continue to generate controversy in current negotiations.

Increasing international concern over growing protectionist trends help spur the beginning of the Kennedy Round of GATT talks which began in 1963.⁵⁴ These talks were likewise considered a success and concluded in 1967. Again focusing on tariff reductions, this set of negotiations managed to reduce average tariffs by 36 to 39 percent from previous levels.⁵⁵ Some strides were made in the increasingly important area of non-tariff barriers as well, perhaps because consensus was becoming more difficult to achieve as tariff reductions cut more deeply into national trade revenues.

The Tokyo Round of GATT talks, which were held from 1973 to 1979 began as an indirect result of the previously mentioned Bretton Woods monetary system's failure and continuing protectionist trends.⁵⁶ These talks focused much more intensively than any previous round on non-tariff barriers. Major accomplishments of this round included the approval of codes of conduct on such barriers. Additional areas of significant progress included: revision of GATT anti-dumping codes, a sectoral agreement on the free trade of civil aircraft, and an agreement on the management of textile trade that later evolved into the controversial Multi-Fibre Arrangement (MFA).⁵⁷ Other accomplishments featured a further reduction of tariffs on industrial products by approximately 27 percent (to an average of five percent), new dispute settlement procedures, and an

important "enabling clause" that allowed preferential treatment for developing countries under a previously signed 1971 accord.⁵⁸ Unfortunately, in a failure that was an omen of things to come, the round failed to result in a safeguards agreement (temporary emergency actions designed to protect threatened industries). This failure converted what was otherwise a successful round into merely a holding action against a rising tide of protectionism.⁵⁹

F. URUGUAY ROUND PRELIMINARIES

The 1982 GATT ministerial meeting in Geneva provided the initial impetus for the Uruguay Round of negotiations. During this meeting, despite some minor breakthroughs, disagreements that were thought to be resolved resurfaced in the areas of agriculture, services, investment practices, and technology.⁶⁰ Failures encountered in implementing Tokyo Round agreements were also discussed. Conflict centered on GATT rules concerning agricultural trade. In addition to the minor breakthroughs that were made, the 88 members present signed resolutions stating their support of the GATT and agreeing on a declaration of trading system problems to be faced in a future negotiating round.

Proposals for a new round, spearheaded by the United States, Japan, and Canada remained the subject of intensive debate until the Council meetings of July and September 1985.⁶¹ Opposition came primarily from developing countries concerned that charges of protectionism would force reductions in their privileges. During these meetings a slim majority followed the lead of a group headed by the

United States to call for a new ministerial meeting. The Punta del Este meetings that followed in January 1986 resulted in a ministerial declaration opening the Uruguay Round.

G. THE URUGUAY ROUND

The ongoing negotiations of GATT's Uruguay Round, which began in January 1986, initially aimed at resolving issues concerning safeguards, agricultural trade, textiles, quantitative restrictions, and tropical products.⁶² They also sought to resolve substantial areas of controversy remaining over the implementation of the previous (Tokyo) round of talks.⁶³

The talks, which began with 78 member teams in 1986, currently involve negotiating teams from 108 countries. The round had an initial deadline of December 1990. However, in October 1992, it remains deadlocked. Further, prospects of completion by the most recently set implementation deadline of 1 January 1993 look doubtful.

During the negotiations, by almost any measure, the Uruguay Round has failed to achieve its goals. Talks have virtually stalemated on the agricultural question, services regulations, intellectual property rights, and investment restrictions (among other issues). To illuminate the stalemate, this section will seek to examine the progress of the talks since 1986 and some of the more visible controversies.

The entering attitudes of participating nations affected the talks from the outset. American business and administration officials were generally supportive about the prospect of resumed talks. Congress, however, was actually making openly protectionist speeches. This led to a dualism in the U.S. negotiating stance which still persists.⁶⁴ Europe, according to trade specialists Michael Aho and Johnathan David Aronson, supported talks with an "...air of resignation, but with no visible enthusiasm."⁶⁵ This was because of threats to European agricultural subsidies that were sure to be a major topic of the talks. Japan favored a new round, not because of a desire for reduced trade restrictions, but instead because they would be "...long and complex and might divert attention from its bilateral trade tensions."⁶⁶ Developing country's positions varied, ranging from doubts about a round's prospects to complete opposition to new talks. Since the rounds began the above attitudes have changed little.

The complexity of the negotiations also created problems from the start. Originally, 15 separate negotiating groups were insisted upon. Though the 15 were reduced in April 1991 to seven, complexity and functional linkages between issue areas has made consensus across the negotiating groups difficult.⁶⁷

Disagreements over agriculture between the U.S. and the EC stalled Montreal negotiations of the round in 1988. Despite the appearance of resolution, similar problems stalled negotiations in December 1990. This time the talks broke down completely as the EC, Japan and Korea refused to concede their position on agricultural export subsidy reform.⁶⁸ American negotiators walked out.

Talks were resumed in March 1991 as a result of an understanding among key negotiators (including the EC). The understanding, engineered by Director General Arthur Dunkel, mandated that "...critical agricultural issues would be addressed explicitly and with reasonable flexibility."⁶⁹ It also confirmed that trade in textiles that had moved outside of the multilateral framework would be gradually returned to GATT control. Finally, it agreed that other areas, such as tariff reduction, intellectual property protection, dispute settlement mechanisms, trade related investment, and services regulations were to be discussed. The spirit of compromise did not last long, and the old acrimony over agricultural (and other) issues quickly resumed.

Another Dunkel sponsored compromise draft, this one submitted on 20 December 1991, received "lukewarm response."⁷⁰ Key actors, the EC, the U.S., and Japan rejected the proposal, once again primarily over disagreements on agricultural issues. Since the January 1992 rejection of the Dunkel proposal the talks have been essentially in stalemate.

A flurry of activity in April, May, and October 1992 proved to be insufficient to complete the round. The April-May activity occurred when EC consensus allowed a proposal to reduce agricultural subsidies brief life and the U.S. responded with signals of increasing flexibility. Unfortunately, this initiative resulted in no substantial action by either side.⁷¹ The October activity appears to have been initiated by a European consensus on the acceptance of subsidized agricultural export tonnage reductions, the elimination of direct subsidies to

farmers, and breakthroughs in the critical area of financial services.⁷² Unfortunately, the European concessions still did not go far enough to achieve agreement, leaving agriculture as the key sticking point.

Because of the existing stalemate, an agreement that will meet GATT deadlines and conclude the Uruguay Round this year, while not impossible, remains unlikely. Further, the ultimate success of the round is in grave doubt. Much more likely is continued stalemate, primarily over agriculture.

H. SPECIFIC ISSUE AREAS

Why have agricultural issues been so controversial? Anthony Rowley of the Far Eastern Economic Review states that attention has focused on agricultural issues during the Uruguay Round because of the "...trade-distorting elements of the \$300 billion U.S. dollars a year which governments worldwide pay to farmers by way subsidies and supports..."⁷³ In purely economic terms such subsidies promote economic inefficiency in some farmers while allowing more efficient producers to gain large economic rents. Subsidy funding is supported by artificially high consumer prices or money from public budgets.

If agricultural subsidies are inefficient why haven't they been eliminated? Agricultural subsidies persist precisely because of the economic inefficiencies discussed above. The political lobby formed by inefficient producers, particularly in evidence in the EC and Japan, is sufficient to inhibit attempts at reform by their representatives. Despite enormous pressure on the EC and Japan from a coalition

of countries, attempts to achieve reductions in agricultural export subsidies of 90 percent by the year 2000 have failed completely.⁷⁴

While agreement on agricultural issues (particularly between the U.S. and the EC) is undoubtedly essential to the successful conclusion of the Uruguay Round, it is, according to Sylvia Ostry of the University of Toronto, "...by no means sufficient."⁷⁵ A successful agreement must also address the controversial issues of regulation of the services trade and trade in intellectual property. Tremendous problems also exist in these areas.

Services now account for approximately 66 percent of American output and up 70 percent of American jobs (providing up to \$90 billion in annual exports). Even though these "goods" account for 25 percent of world trade, no international rules of "fair play" exist to govern their exchange.⁷⁶ Specifically at issue are appropriate rules for trade in services and full sector coverage for all types of trade. Because services, particularly financial and telecommunication services, are likely to form the future infrastructure of the world economy, agreement in these areas is particularly critical. Interestingly, the U.S. and EC generally agree on regulations in this area that require services to be subject to MFN rules. Resistance is primarily coming from developing countries in Asia who, in particular, object to the opening of their banking service sectors.⁷⁷ Agreement on this divisive issue looks almost as difficult to achieve as an agreement in agriculture.

Intellectual property is another major area of disagreement. Worldwide losses due to inadequate protection of intellectual property rights cost American

industry alone an estimated \$60 billion a year.⁷⁸ America and other industrial countries feel protection of innovator rights to their intellectual property must be guaranteed by international agreement. Many developing countries, on the other hand, feel such regulations would stifle their own innovators as well as being extremely costly to administer. As a result agreement on this area remains unlikely as well.

Even if consensus is reached under the Dunkel or a subsequent compromise agreement on the central issues: agriculture, services, and intellectual property, the agreement is likely to be a bitter one. The breadth of the gaps between the positions of key members is so great that required concessions may not play well to home constituencies. Indeed, European farmers are already protesting proposed agricultural compromises.⁷⁹ Any agreement will face an uphill battle for ratification in many member countries. As a result, even if negotiators beat deadlines with an agreement, the likelihood of successful ratification must remain in serious doubt.

If this is not enough to doom current talks, many other issues, though less central to the current stagnation of GATT talks, could become controversial enough to prevent an agreement before the 1993 deadline as well. A few of those include: safeguard rules, dispute settlement laws, local content rules, tariff reductions, dumping/anti-dumping regulations, voluntary restraint measures constraints, sector specific subsidy rules, and textile regulations (particularly the

integration of the MFA into GATT). Disagreement in any one of areas could prevent a successful conclusion to the Uruguay Round.

I. FUTURE PROBLEM AREAS

Even in the unlikely event that agreement is reached on the above controversies, and the Uruguay Round of GATT is successfully concluded, the future of the organization as it stands today is not bright. Unresolved and unaddressed problems will continue to dominate the organization, potentially precluding the successful implementation of a Uruguay accord. This section will briefly highlight a few of the more important problem issues for the GATT.

Out of ten broad obstacles facing GATT cited by Aho and Aronson, three continue to be most important. There is no sign that they will be resolved during current negotiations.

First, global interdependence, particularly in the financial sector, has accelerated as a result of the end of the Cold War. This has made both nations and the international economy more sensitive to actions in domestic economies as a whole.⁸⁰ GATT, in the Uruguay Round, has been unable to find a forum to deal with the effects of member domestic economic actions on the international economy. Until it does, no agreement can be effective enough to ensure GATT's survival.

Second, declining American economic dominance also causes problems that have not been addressed by current GATT negotiations. The U.S. no longer has

the financial ability, even if it has the will, to make the concessions necessary to maintain its undisputed leadership in GATT.⁸¹ Yet to date, no other international actor has come forward to fill the gap left by the withdrawal of American leadership.

A related problem, which economist Jagdish Bhagwati calls the "diminished giant syndrome," involves the psychological need of America to dominate world trade coupled with the financial inability to do so. The resulting "trade panic" on the part of America leads to protectionist trends in the U.S. that GATT has been unable to handle.⁸²

Third, the breakdown of sectoral distinctions between markets and agreement areas is redefining international trade. Aho and Aronson cite the example of financial supermarkets replacing separate banking, brokerage, and insurance industries.⁸³ This problem is particularly acute in burgeoning service sectors but similar effects can be found in other industries (including telecommunications and computers) as international corporate structures evolve. Sectoral merging has, and will continue to create enormous difficulties for GATT in the regulation of international trade. However, at least partially because the evolution is an ongoing process, it has been addressed only on the most superficial level by GATT.

Other problems are also important. The failure of GATT to link trade rules and policies to environmental issues, its inability to proceed with reforms at a faster pace than that of its most reluctant member (the convoy problem), and

problems with the regulation of the growing high technology sector (among others) are just four examples of vital issues not currently being fully addressed by GATT.⁸⁴

The most important issue that the Uruguay Round is failing to adequately consider is that of institutional reform. As previously stated, the GATT has been unable to fully apply the mandates of the Tokyo Round which ended in 1979. Though dispute settlement mechanisms might be strengthened as a result of the Uruguay Round (if it is successful), without greater enforcement power for GATT institutions such reform is irrelevant.⁸⁵ If not addressed within GATT, this failing will allow protectionist actions on the margins of GATT to go unchecked in the future.⁸⁶ Unfortunately, the granting to GATT institutions of greater enforcement power does not seem to be a priority of this round. Even if it was made a priority, agreement would be unlikely due to member state's overriding concerns about conceding vital elements of national sovereignty. This issue alone is quite capable of damaging the GATT beyond repair.

Some feel that unless the GATT is comprehensively reformed to resemble a more powerful and comprehensive World Trading Organization (WTO) that any agreement achieved under the GATT would be unenforceable.⁸⁷ Others simply echo Clyde Prestowitz, who states, "the Uruguay Round was never likely to cure the ills of the world trading system" because, "...few nations would obtain significant concrete benefits."⁸⁸ Regardless of which line of thought a reader supports, the question of success in the Uruguay Round becomes moot. Clearly,

GATT, as it stands, is not capable of taking the regulatory actions necessary to ensure stability and growth in world trade. The new question must be, are there plausible alternatives to the GATT?

III. A GATT ALTERNATIVE: REGIONAL FREE TRADE AREAS

Free Trade Areas (FTAs) have been in existence during the entire post-WW II period. As previously mentioned, these associations were effectively authorized under the auspices of GATT article 24. This article allowed the formation of a single customs territory where:

"all tariffs and other restrictive regulations of commerce as between the territories of members of the union are substantially eliminated and substantially the same tariffs and other regulations of commerce are applied by each of the members of the union to the trade territories not included in the union."⁸⁹

Over the years, many have been organized, all with varying degrees of effectiveness, stamina, and solidarity.

Currently, only three regions have the recognizably continuous levels of unity and activity necessary to reasonably be identified as FTAs. These three, the EC, the proposed North American Free Trade Area (NAFTA), and the Association of Southeast Asian Trading Nations (ASEAN), may well, in the future, form the core of the international trading system. The chief problem for the U.S. is to determine what effect these regional actors will have on the American economy.

To determine the economic effects of the above trading areas on America the forms and functions of the three actors must be clear. This chapter will briefly examine each FTA in terms of the historical conditions of its formation, its recent

evolution, and its plausible future. By doing so, the area's potential future roles with respect to the U.S. may begin to be determined.

A. THE EUROPEAN COMMUNITY

The European Community is arguably the oldest and most successful FTA in existence. This section will briefly examine the EC in terms of its historical development, its current status, and its prospects for the future. By doing so, the evolution of the EC as the first and most firmly established modern FTA can be demonstrated.

1. EC Development and Current Status

In the aftermath of WW II the Marshall Plan was implemented by the U.S. to aid in European reconstruction. As part of that plan America, in the late 1940s, supported efforts by key European leaders to form a customs union.⁹⁰ American encouragement gave impetus to a growing European consensus supporting relaxation of trade restrictions. With this support, preliminary discussions on economic cooperation began during the July 1948 Paris meetings between European leaders. The process was given further momentum by the May 1950 proposal of French foreign minister Robert Schuman calling for sector specific trade cooperation. This proposal led to the establishment of the European Coal and Steel Community (ECSC), with six original European signatories.⁹¹

According to career foreign service officer Herbert Weiner the ECSC structure was a first step in "... realizing the vision of Europe-wide

cooperation.'⁹² Clearly, the ECSC was the nucleus of an effective FTA that continues to grow today.

The formation of the ECSC led directly to the creation of the European Economic Community (EEC) in the late 1950s. By 1955, Belgium, the Netherlands, and Luxembourg had proposed a common market covering all trade as a replacement for the sector specific ECSC. This proposal rapidly gained support throughout Europe and resulted in the "Treaty of Rome" signed in March 1957 by France, West Germany, Italy, Belgium, the Netherlands, and Luxembourg. The treaty, implemented on 1 January 1958, firmly established the fledgling European Community.

Notably absent from the community process were Britain, Denmark, and a few other countries. These nations excluded themselves from membership, preferring instead to join another organization, the European Free Trade Association (EFTA) which espoused less comprehensive trade cooperation.⁹³ Britain was not to join the EEC until much later and full EFTA member integration into the European Community (EC) is still continuing.⁹⁴

The signatories of the Treaty of Rome agreed on two major objectives under treaty auspices. First, they agreed to pursue the formation of a common free trade area through the removal of tariffs, the elimination of quantitative restrictions, and the control of non-tariff barriers to trade by 1970.⁹⁵ Second, the treaty set the goal of establishing relationships to promote the free movement of services, people, and capital through the community. The specific methodology

to be used in the accomplishment of the broad goals above was left open to further negotiation. The resulting disagreements between members over details of methodology is at the root of problems that continue to plague the community to some degree.

Despite vagueness in the area of specific methodology the treaty did create infrastructure necessary to begin the trade liberalization inherent in an FTA concept. This infrastructure, in fact, went beyond the notion of a customs union to establish institutional mechanisms such as executive bodies and a community judicial system which were later to prove essential to the continuing vitality of the organization.⁹⁶

The structure's effectiveness speaks for itself. EC trade soon grew twice as fast as trade in the rest of the international economy, quadrupling in the first decade after 1958.⁹⁷

By the late 1960s the FTA that exists today was virtually complete. Despite some conflict, particularly with the French, critical common agricultural policy had been established for most commodities by 1966. Common agricultural policy was to be completely established by 1968.⁹⁸ Further, by July 1968, tariff and quota restrictions on internal community trade had been eliminated and a common external tariff was in place (18 months ahead of schedule). Finally, tentative steps were being taken toward monetary union. The "Triffen" proposal advocated a single European currency controlled by a European monetary authority.⁹⁹ Though creation of monetary integration would place the EC a step

beyond most conceptions of a simple FTA, that this proposal was made at all shows the depth, even at this early stage, of European sentiment concerning integration. A European FTA was on track and ahead of schedule.

Despite a period of stagflation world-wide during the 1970s, and some internal problems with inflation and deficit growth, the EC continued to grow. Nations that had not been original signatories, including the United Kingdom (critical to a viable future for an EC FTA), either joined or seriously began to seek membership in the community.¹⁰⁰ By 1991 membership had grown to include 12 countries, with more seeking to join (list of membership in Appendix D).

Also during the 1970s, the community undertook steps aimed at strengthening both its policies and institutions. Treaties amending budgetary procedures were adopted in 1970 and 1975. These treaties clarified both the budgeting process and organizational relationships between internal EC institutions.¹⁰¹ Additionally, initial foreign policy cooperation (on a limited basis) under the auspices of European Political Co-operation (EPC) was initiated, the European Council was institutionalized, cooperative association was resolved with the EFTA, and the 1975 Lome Convention was signed to provide a de-facto support system for former EC colonies (primarily French). Finally, despite the failure of similar proposals in 1970, 1972, and 1975, a European Monetary System (EMS) was established by agreement in 1979.¹⁰² With the European Currency Unit (ECU) as its base, this system's aim was (and remains) to create monetary stability.¹⁰³

The changes made during the 1970s, though in some cases relatively minor (with regard to their effect on the global trading system), were to be the foundation of further significant integration during the 1980s. The 1980s saw the EC take steps to reform problem areas. Major budgetary and agricultural policy reform was undertaken because soaring agricultural export subsidy and storage costs forced a budgetary crisis. A reform package, accepted by the Council in 1988, relied on price discipline and structural reform to restore efficiency to the faltering agricultural support system.¹⁰⁴

Most important during the 1980s were the further steps taken toward community integration. These steps have been construed by some as the opening salvos of a trade war and the development of a hostile regional trading bloc (RTB) based in the European Community.

The 1984 draft treaty for European Union strongly stated the case for increased federalization of the EC.¹⁰⁵ Such an agreement might well have moved Europe far beyond a simple FTA structure toward complete unity politically. The arrival of federation-oriented Jaques Delors as president of the European Commission in 1985 gave further impetus to this movement.¹⁰⁶

The watershed event in the move toward federation of the EC came with the 1985 publication of a community "white paper" containing the plan to complete an internal market by 1992. This document, says National Planning Association fellow Michael Calingaert,

...brought together for the first time a comprehensive listing of the measures deemed necessary for achieving the goal of a single integrated market and included a timetable for action on each individual measure, with the entire process scheduled for completion by the end of 1992.¹⁰⁷

The offspring Single European Act (SEA), used the white paper timetable and improved elements of the 1984 draft treaty to provide an improved compromise proposal. That proposal was signed in 1987 at Maastricht, the Netherlands. Implementation was given momentum by the 1988 Delors Commission three-phased integration process proposal.¹⁰⁸ The goal for implementation has been set for January 1993. A second Maastricht agreement, signed in December 1991, proposes a single currency under a European monetary system (essentially pegged to the German mark) and further political integration.¹⁰⁹

The size of the community and the potential commercial advantages of integration give powerful stimulus to the integration movement. The community, with the addition of the EFTA, would have a Gross Domestic Product (GDP) ranking among the largest in the world (behind the U.S.) and contain more than 380 million consumers (Table IV).

TABLE IV.

COUNTRY/AREA	1989 ESTIMATED GDP IN MILLIONS OF DOLLARS	APPROXIMATE CURRENT GROWTH RATE
EC	4,450,335	2.1

Sources: Averaged data based on conflicting sources from *International Marketing Data and Statistics 1992*, 16th ed., (London: Euromonitor, 1992); and *North America: The New Competitive Space* (New York: The Conference Board, 1991)

It is also worthy of note that as long ago as 1988 the EC accounted for nearly a quarter of world trade (40 percent if intra-EC trade is included).¹¹⁰ Most importantly, though still a point of contention, a recent European Commission analysis (the Cecchini Report) predicts five to six percent regional GDP growth as a result of the single European market.¹¹¹

The implementation of the second Maastricht treaty would, in essence, move Europe beyond a common market to full economic union. This proposal, however, remains in deep trouble. Because of the fear that monetary and political unity could lead to losses of sovereignty and national identity, Danish voters narrowly rejected the treaty in June 1992. Voting was extremely close with percentages of 50.7 to 49.3 percent.¹¹² Additionally, though the referendum narrowly won a September referendum in France, it remains threatened by enormous dissent in England. Here also, serious debate has centered on the public's dissatisfaction with a proposed common monetary system and potential losses of national sovereignty that could occur under the treaty.

Despite problems with this second Maastricht treaty, the SEA, which concerns only market integration, is almost certain to be implemented on schedule. However, whether or not the goal of full integration is met by the EC remains to be seen.

Whatever happens, the future of the EC continues to be the subject of intense debate. Strangely, the debate is largely centered within the European community between factions favoring (or opposed to) increased federalization.

International protest, which could be expected if hostile trading bloc development was deemed an issue, has been minimal. Nevertheless, the process of European integration has tremendous importance for the further development of North American and Asian FTAs.

Will the failure to ratify the EC 92 agreement spell the end of the European Community as an FTA? What does the future hold for the EC? These are the questions to be answered by the next sub-section.

2. EC Futures

The future of the Maastricht treaty is difficult to predict. Political analyst Alan Riding has recently stated that "The issues are so complex that ordinary people seem baffled."¹¹³ The complexity of the agreement generates suspicion in many Europeans minds. Exacerbating the problem is the fact that the future of a united Europe "...is being argued behind closed doors by a small number of officials..." and with little input from ordinary citizens.¹¹⁴ Clearly, full European monetary and political integration is not certain.

In addition, long-term obstacles to integration still exist. Despite increasing European homogeneity, differences in the areas of culture, language, and tradition still separate European nations. Other, more concrete differences exist in the areas of tariff regulations, dumping/origin rules, quotas, standards, and other trade issues. These will not go away or be resolved quickly. As a result, further integration may be a slow process.

Regardless of the problems and the relatively slow pace of integration, levels of EC integration are expected to continue to grow. Experts on international trade from many backgrounds support this view. College of Europe professor John Pinder notes:

There is no such thing as automatic spillover or inevitable progress toward federation. But given the continued growth of interdependence in the real economies of the member countries, the strength of the political commitment to further unification, the existence of solid community structures on which further integration can be based, and the dynamism that the community has shown since 1985, further development of the community's competences and institutions appears likely.¹¹⁵

Italian merchant banker Leonardo Chanez agrees and states that "European unity is already happening despite the slow pace of the bureaucrats."¹¹⁶

The above view can be lent credence by the examination of three decades of EC integration. Analyzing trends in intra-EC and extra-EC trade for the last three decades, economist Jeffrey J. Schott concluded that, "the growth of intra-EC trade has far outpaced the growth of exports to third markets."¹¹⁷ Michael Calingaert thus appropriately argues that "...the question is not whether the European Community will move toward a single market, but rather how far and how quickly."¹¹⁸ The continued existence, and further integration of the European Community appears inevitable.

But what if, in some unforeseen scenario, integration irrevocably stalls? Will the European FTA then cease to exist? Will the FTA cease to be a potent force in world trade? The last two questions can be answered with a simple no. If the community integration process stalls the EC will not cease to exist. The FTA

will survive no matter what the fate of the federalization effort. Further, it will continue to be a potent force in world trade. This issue here, as with the other two FTAs we shall explore, is not whether or not such blocs will form. Integration instead, is simply a matter of degree, of more or less free trade within each bloc, more or less levels of federalism within each bloc, and more or less protectionist practices in external trade on the part of each area. This is the essence of the FTA question.

In conclusion, full monetary and political integration may or may not be inevitable in the EC. However, most experts in the field agree with political analyst and trade correspondent Craig R. Whitney, who argues that if the process stalls, if the treaty dies a quiet death, then the EC would simply be left to "...become the giant free-trade bloc of sovereign states that the member countries had already planned before the Maastricht accord."¹¹⁹

Thus, it is appropriate to acknowledge, for policymaking purposes, that the perceived benefits of the EC FTA are too attractive to allow its disintegration. Europeans have come to rely on the large internal market and improved services made possible by the EC. As a consequence, the EC will retain its powerful influence on world trade and its survival will continue to encourage the development of FTAs in other regions.

B. THE NORTH AMERICAN FREE TRADE AREA

This section will explore the second most active FTA formation process in existence today, the North American Free Trade Area (NAFTA). This potential FTA is currently anticipated to include the United States, Canada, and Mexico.¹²⁰ In examining the potential NAFTA this section will illustrate that a free trade pact between the U.S., Canada, and Mexico is ultimately inevitable simply because it is in each national actor's long-term best interest.

Initially, the discussion will focus very briefly on historical issues affecting the debate, including historical milestones in U.S.-Mexico and U.S.-Canada trade relations. Then, to predict the future of the NAFTA agreement, an examination will be made of the agreement's basic structure and the likelihood of successful agreement completion. By examining these issues, the economically necessary NAFTA can be demonstrated to be assured of ratification in all three negotiating countries, resulting in the implementation of a North American trade alliance for Mexico, Canada, and the United States.

Free trade under the auspices of NAFTA, considered by many to be a necessity for long term North American economic growth, has long been the subject of debate at all levels of the American, Canadian, and Mexican policymaking process. If current debate is resolved in favor of free trade proponents, the resulting market would easily rival the unified EC and EFTA market in collective GNP. To illustrate the size of such a market, consider the

combined 1989 GDP of \$5,914 billion for North America (see Table V) as compared to a significantly smaller GDP of \$4,145 billion for the EC.

TABLE V.

COUNTRY/AREA	1989 GDP IN MILLIONS OF DOLLARS	1989 REAL GDP GROWTH RATE
United States	5,163,200	2.5%
Canada	550,354	3.0%
Mexico	200,712	3.0%
Total	5,914,000	2.8% (avg)

Sources: *International Marketing Data and Statistics 1992* (London: Euromonitor, 1992) and *World Development Report 1991: The Challenge of Development* (Oxford: Oxford University Press, for The World Bank, 1991).

Based on the trends above, NAFTA might well compete favorably in global markets with the unified EC.¹²¹

1. The U.S.-Mexico Relationship

Historically, the participation of America in the Mexican economy has often been characterized by policies of blatant interventionism in Mexican affairs. These American policies, for many years, shaped Mexico's attitude toward the United States, giving Mexico a fierce determination to ensure economic autonomy was retained.

The first sign of a thaw in Mexico-U.S. trade relations came with the Mexican establishment, in the late 1960s, of the Maquiladora concept. The

Maquiladora structure was defined by Mexico as industrial locations with up to 100 percent foreign ownership, producing finished goods (largely for export) from imported components.¹²² These industries rapidly became highly profitable for both Mexico and the United States. Initially only authorized in near-border areas, Maquiladoras are now spread throughout Mexico.

By the 1970s Mexico was the third ranking U.S. trading partner and the deepened U.S.-Mexico relationship continued to grow. In 1986, partially as a result of a 1982 debt crisis and resulting pressure from the U.S., Mexico, with America's help, successfully lobbied to join the GATT structure, thereby internationalizing their trading role.

By 1987, Mexico had signed the U.S./Mexico Framework Agreement, establishing an initial mechanism to discuss and resolve trade issues through "working group" negotiations in most economic sectors.¹²³ The Framework Agreement, together with recent reforms implemented by President Carlos Salinas De Gottari have formed the underpinnings of improved collaboration on trade issues between the U.S. and Mexico.¹²⁴

The results speak for themselves. U.S. trade with Mexico has doubled since 1986 (\$59 billion in 1990).¹²⁵ At least 264,000 jobs have been created.¹²⁶ Average tariff rates have also been reduced (from 28.5 percent in 1985 to 11.8 percent by 1987 and still further to 9 percent by March 1991).¹²⁷ Most importantly, levels of interdependence have been increased and the basis of cooperation necessary for a free trade agreement have been set.

2. The U.S.-Canada Relationship

According to economist Maureen A. Farrow and policy analyst Robert C. York, the Canada-U.S. free trade agreement had its "roots" deep in their mutual economic history, "...beginning with the Reciprocity Treaty of 1874."¹²⁸ A relatively close relationship has continued since, highlighted by free trade agreements in agricultural equipment (1944) and automotive products (1965). Economists Gary Clyde Hufbauer and Jeffrey J. Schott concur, particularly noting the 1965 Auto Pact as the modern "foundation stone" of a gradual and continuing process of North American economic integration.¹²⁹

Canadian-U.S. integration has been, over the years, an evolutionary process based on gradually increasing levels of interdependence. As such, at least within the United States, the Canada-U.S. free trade agreement generated relatively little debate during its negotiation and approval phases. Members of the U.S. Congress, in particular, seemed relatively indifferent to the negotiations process.¹³⁰ This may have been, in part, due to the perceived equality between U.S. and Canadian economies. It may also have been partially due to a more limited role played by Congress in trade issues prior to the end of the "Cold War."

Another important reason for lack of American congressional opposition to the U.S.-Canada agreement may have significant bearing on current NAFTA negotiations. The lack of debate in Congress may have been due to reluctance on

the part of American congressmen, when confronted with a decision on the issue of free trade, to go on the record as a "protectionist." The same reluctance to demonstrate protectionist behavior might be a large factor limiting negative U.S. congressional action in the NAFTA ratification process. This could be a deciding factor in agreement implementation.

Opposition to the agreement, in the U.S., was centered in the states who anticipated negative effects on home industries. Protest to the agreement rallied around these states' congressmen. The result was isolated and essentially ineffective opposition to the agreement. Unified support for the agreement was primarily generated by the executive branch, the National Governor's Conference, business groups, and key congressmen such as Senator Lloyd Bentsen (D TX) and Representative Dan Rostenkowski (D IL).¹³¹

As previously noted, however, discussions in Congress were generally non-combative, being centered on job losses and specific industry concerns. When the bill was formally introduced, it quickly passed in both chambers.¹³² Similar trends in support may be readily seen in the ongoing NAFTA debate.

Interestingly, the bill met with major public debate in Canada and became the primary campaign issue for Prime Minister Mulroney's conservative party. Mr. Mulroney was narrowly reelected and subsequently pushed the bill through Commons just days before planned implementation on 1 January 1989. The reason for this difficulty seemed to be fear of the U.S. economic might overwhelming a smaller Canadian economy and increasing levels of American

protectionism.¹³³ If Canadian fears of combined U.S.-Mexico economic strength parallel those of the U.S.-Canada free trade negotiations, they may also be significant but should not be sufficient to prevent a NAFTA agreement.

Many of the mechanics of the Canada-U.S. agreement parallel those which may be expected in the NAFTA (see Appendix E for specifics). In particular, a strong arbitration commission can be expected to be an essential part of any NAFTA agreement.

Quantitative estimates of the results of the U.S.-Canada Free trade agreement are premature because the 10 year phase in process is incomplete. Preliminary results, however, indicate that the agreement is contributing to increased trade.

Levels of trade in 1990 were \$84 billion, an 18 percent increase in the first year of operation.¹³⁴ Further, the agreement has, according to Farrow and York, allowed Canada to realize economies of scale and specialization thus "rationalizing its production" and becoming "...more competitive in an increasingly competitive international marketplace."¹³⁵

Though some Canadian critics blame the free trade agreement for economic ills associated with the recession of the last two years, most economists disagree. Noted economists Gary Clyde Hufbauer and Jeffrey J. Schott recently stated that much of this criticism is "exaggerated and misplaced" reflecting sovereignty concerns, discomfort with the prospect of structural adjustments, and uneasiness with the implications of structural adjustments for expensive public

programs.¹³⁶ Trade correspondent Clyde H. Farnsworth fundamentally agrees, citing the \$200 billion in trade between the two countries in 1991 (the greatest volume between any two countries in the world) as proof that the pact has been beneficial to both sides.¹³⁷ Most experts feel that the benefits of the above agreement would also translate to a broader NAFTA agreement.

3. Potential NAFTA Structure, Benefits, and Prospects

Mexico-U.S. trade relations have been continuously improving for two decades. The Canada-U.S. free trade agreement appears to be a clear success. These factors, combined with the growth of regionalism globally, are in the process of combining to make the ratification of a free trade agreement covering all of North America highly likely. This section will examine the basic structure of a potential NAFTA agreement, its expected benefits, and its current prospects for ratification.

In May 1990 Mexican President Salinas called for the creation of a U.S.-Mexico free trade agreement with the overwhelming support of the Mexican Senate.¹³⁸ Soon after, in June of 1990, Presidents Bush and Salinas jointly announced their intentions to pursue an agreement.¹³⁹ A formal request from President Salinas followed and President Bush notified Congress of his intent to negotiate on 25 September 1990.¹⁴⁰ Subsequent to a formal request by Canada for inclusion in the talks, President Bush, President Salinas, and Prime Minister Mulroney announced joint talks on the proposed NAFTA agreement on 5 February 1991.¹⁴¹ After seven negotiating rounds, on 12 August 1992, a NAFTA

Accord was initialed by all three negotiating parties and submitted to their respective legislatures for ratification.¹⁴²

The intention of NAFTA negotiations has been to make the agreement profitable to all three countries while providing general adherence to GATT Article 24 guidelines. To that end, talks in nineteen NAFTA negotiating groups centered on the phased reduction and ultimate elimination of tariffs in all three countries. They have also addressed non-tariff barriers such as licensing, quotas, subsidies, and barriers to investment flow. Other, secondary (but still significant) issues included services, intellectual property rights, government procurement policies, standards/certifications testing, customs requirements, rules of origin, entry/exit restrictions, narcotics, immigration, human rights, energy issues, and the environment.

The key element of the resulting NAFTA plan is the elimination of customs duties on "tens of thousands of items," over periods of up to 15 years.¹⁴³ Other important provisions liberalize trade relationships in the areas of advertising, agriculture, autos, banking, energy, the environment, food safety, government contracts, insurance, securities, work visas, textiles, and trucking. Dispute settlement procedures were also constructed.

National objectives in the NAFTA agreement vary from country to country (see Appendix F) and perceived benefits vary with the background of the supporter and their specific agenda. Some prevailing positions are, however, clear. Analysts William J. Holstein and Amy Borrus report that, in general; "...the largest

companies in all three countries favor a continental free-trade zone..." while "...labor unions, smaller companies, and less efficient industries are lobbying against it."¹⁴⁴

Regional and congressional lobbying by state and local governments is also providing a great deal of support for the NAFTA agreement. Cross-border associations of such actors are capable of exerting tremendous pressure on policymakers to support free trade.¹⁴⁵

Undoubtedly, both sides of the debate make certain valid points, particularly if a micro-economic focus is taken. Nevertheless, for all three nations, serious analysis shows that any losses produced by NAFTA implementation should be more than offset by greater long-run economic efficiency.

That a NAFTA would have at least two key benefits now seems generally accepted. First, economists Gary Clyde Hufbauer and Jeffery J. Schott have given credibility to the hypothesis that a NAFTA would promote the efficient use of natural and human resources throughout the region. Using a historical approach dubbed the "IIE model," Hufbauer and Schott have found, based on a detailed analysis, generally positive benefits associated with a NAFTA.¹⁴⁶ Though the magnitudes of gains and losses showed some variability, not only the IIE but six other existing models, when compared, supported the notion that a NAFTA would increase economic efficiency and generally benefit all three participants.¹⁴⁷ The IIE model specifically forecasts that a NAFTA (together with continued Mexican reform), would by 1995, generate an extra \$16.7

billion in U.S. and \$200 million in Canadian exports while creating 600,000 Mexican and 325,00 U.S. jobs.¹⁴⁸

Several other studies generally supported the Hufbauer and Schott results. These studies found that less dramatic, but generally positive results could be expected for all countries in a NAFTA.¹⁴⁹

Second, it is quite probable that the NAFTA would insure all three nations against sudden changes in trade policy that could lead to increased discrimination or protectionism in the region. Though this hypothesis is, as yet, unproven, an examination of the stability enhancing effects of other international organizations would likely lend the idea credibility.

In the long term all evidence points to an increase in value added jobs as exports increase. Further, as stated, overall employment levels will increase. The movement of low skill final manufacturing to Mexico will improve overall North American competitiveness in world markets. This, in turn, should help preclude movement of industry to locations with lower labor costs (like Asia). Finally, such a scenario will also result in a growth of demand for skilled American or Canadian labor to produce complex components for final assembly in Mexico.¹⁵⁰

The benefits of a NAFTA, combined with the solid determination of United States and Mexico to achieve agreement have added strong impetus to the NAFTA movement. Canada, forced to participate (if for no other reason because of their unwillingness to be left out), has simply cooperated.

The concessions made by President Bush in his May 1991 "Action Plan" gave significant impetus to the negotiating process. This plan assuaged key concerns of American and Canadian legislators and made critical concessions on central opposition issues at a politically appropriate time. By supporting associated gradual tariff reductions, tough rules of origin, worker retraining/dislocation assistance, labor standards, maintenance of immigration standards, and strict environmental regulations President Bush silenced key domestic American opposition to NAFTA.¹⁵¹ The Bush concessions may have relaxed considerable Canadian opposition as well. These actions undoubtedly played a major part in the successful conclusion to negotiations in August 1992.

Significant progress towards a viable NAFTA has been made. Compromises have been reached in critical areas and all three chief negotiators, Carla Hills (U.S.), Michael H. Wilson (Canada), and Jaime Serra Puche (Mexico) have indicated by their endorsement that they are satisfied with the result. Mexico, in particular, has embraced the accord.¹⁵²

Despite the progress, American and Canadian domestic political concerns may prevent ratification of a NAFTA agreement this year. In the both the U.S. and Canada, this is because of the agreement's importance as campaign issue in the reelection bids of President Bush and Prime Minister Mulroney.¹⁵³

Long term prospects look better. President Bush has often reaffirmed his commitment to the NAFTA. Presidential candidate Bill Clinton has also been a consistent NAFTA supporter. Though election year politics and pressure from

organized labor may prevent Mr. Clinton's vocal support prior to the election, the probability of his long term support for a North American free trade agreement is high (based on his record in Congress). Since the agreement cannot realistically come to a vote before the November election, it is probable that no matter which candidate is in the White House in January, support for a NAFTA will be ensured.¹⁵⁴

In Canada, Prime Minister Mulroney faces a significant battle for ratification of NAFTA. However, he has been a successful crusader for free trade before (during the negotiation of the Canada-U.S. FTA in 1989). As the position of Mulroney's conservative party remains strong, it is likely he will succeed in the ratification process again.¹⁵⁵

The treatment of the FTA issue by the U.S. Congress is more problematical. Delay in ratification of a completed NAFTA agreement by an American Congress, afraid of alienating labor in an election year, is certain. This may, however, provide no more than a temporary impediment to final FTA treaty ratification. Even those Democratic congressmen currently speaking out against the agreement do not actually condemn a NAFTA. Rather, like Senator Max S. Bacus (D MT) and Senator Lloyd Bentsen (D TX), they condemn either the maneuverings of the Republican administration in submitting the agreement during an election year, shortcomings in worker retaining programs, or flaws in border environmental cleanup requirements.¹⁵⁶ They do not condemn the agreement or argue against its necessity. Senator Bentsen, in fact, acknowledges

the bipartisan majority in Congress favoring free trade.¹⁵⁷ Given the eagerness of the administration and business, together with America's free trade orientation, it is unlikely that current congressional reluctance will do more than delay agreement. Some form of NAFTA will almost certainly be approved.

Mexican President Salinas may have been correct when he recently stated that the agreement is "inevitable."¹⁵⁸ NAFTA ratification is likely.

Still, just as in the case of the EC one must ask, what if, for any reason, the agreement fails? What will then be the progress of North American free trade? Most analysts believe that linkages between the North American countries will continue to grow whether or not NAFTA goes through.¹⁵⁹ Sidney Weintraub, the premier thinker in the area of North American trade relations, has generally agreed; noting in the particular case of U.S.-Mexican integration that "...the industrial strategies in the two countries are not completely separable..."¹⁶⁰

Thus, because of growing North American economic interdependence, continuing cultural links, and geographic contiguity, North American trading relationships will become both broader and deeper. As a result, regional linkages will grow. A regional trading area is the most likely result. It is wise, then, to formulate American economic policy based on the existence of a North American FTA. Once again, as in the case of the EC, the difference between alternatives may be only a matter of the length of time it takes to come to terms, the depth of trade liberalization, and the extent of any externally protectionist behavior.

As a consequence of the existence of the two potential FTAs discussed above, the EC and NAFTA, industrialized countries in Asia are likely to continue their move toward the development of an Asian FTA as a simple matter of survival. With that in mind, the future of free trade in Asia will now be briefly considered.

C. THE ASIAN FREE TRADE AREA

This section will examine the third large free trading area now in its formative stages. Though clearly the most tenuous of the three FTAs discussed, this FTA, known as the Asian Free Trade Area, appears to be coalescing around the leadership of the developing nations that are members of the Association of Southeast Asian Nations (ASEAN) group.

The emerging Asian FTA will be examined, as the EC and NAFTA have been previously, in terms of its historical development and its current status. Since the Asian FTA proposal originated with ASEAN, the majority of the section will be devoted to ASEAN's role in the developmental process.¹⁶¹ However, because of the continuing strong influence of the newly industrialized Asian economies (Hong Kong, South Korea, and Taiwan) and Japan as regional actors, those nation's roles in a future Asian FTA will also be briefly explored.¹⁶² The analysis of these issues will illustrate that though further development of an Asian FTA is not certain, it is more likely than not.

An Asian FTA centered in ASEAN would have a potential market of at least 330 million increasingly wealthy consumers. Based on size alone it could wield tremendous economic influence in the global economy.¹⁶³ More importantly, with an average regional growth rate in the neighborhood of six to seven percent, the area has great potential for the economic influence in the future.¹⁶⁴ It might, in fact, become an influential third leg of a future global triad of trading communities.¹⁶⁵

The potential Asian FTA currently includes the ASEAN members Indonesia, Malaysia, Thailand, the Philippines, Singapore and Brunei under the umbrella of the ASEAN FTA (AFTA) agreement. A fully integrated organization consisting solely of these nations would potentially have relatively impressive economic might (Table VI).

If, as is likely, the AFTA was joined by other wealthy Asian nations, the results would be more dramatic. Realistic candidates would include the newly industrialized economies (NIEs) of Hong Kong, South Korea, and Taiwan Table (VII). Due to the magnitude of these nations' output, such integration would ensure a global role for an Asian FTA.

TABLE VI.

COUNTRY/AREA	1989 GDP IN MILLIONS OF DOLLARS	1989 REAL GDP GROWTH RATE
Brunei	3,700 *	3.5%
Malaysia	37,483	8.8%
Singapore	28,359	9.2%
Thailand	69,683	12.0%
Philippines	44,373	5.6%
Indonesia	93,966	7.4%
AFTA Total	277,564	7.8% (average)

*1988 estimate only. No other information available

Sources: *International Marketing Data and Statistics 1992*, 16th edition (London: Euromonitor, 1992), *World Development Report 1991: The Challenge of Development*, *The Economist Book of Vital World Statistics* (London: Random House, 1992), and *Economic Report 1991/1992* (Malaysian Ministry of Finance, 1992).

TABLE VII.

COUNTRY/AREA	1989 GDP IN MILLIONS OF DOLLARS	1989 REAL GDP GROWTH RATE
AFTA Total	277,564	7.8% (average)
Hong Kong	62,924	2.3%
South Korea	212,970	6.2%
Taiwan	148,205	7.6%
AFTA/NIE Total	701,663	6.0% (average)

Sources: *International Marketing Data and Statistics 1992* (London: Euromonitor, 1992) and *Economic Report 1991/1992* (Malaysian Ministry of Finance, 1992).

1. ASEAN Development

The currently developing Asian Free Trading Area is being spawned under the umbrella of the Association of Southeast Asian Nations. ASEAN, conceived in Bangkok in 1967, was intended to replace a relatively ineffective predecessor, The Association of Southeast Asia, dating from 1961. As formulated in its founding document, the Bangkok Declaration, ASEAN was intended to:

...accelerate the economic growth, social progress and cultural development in the region through joint endeavor in the spirit of equality and partnership in order to strengthen the foundation for a prosperous and peaceful community of Southeast Asian nations...¹⁶⁶

The declaration also called for cooperation in "the development of basic commodities, industrial cooperation (in the form of five large industrial joint ventures), cooperation in trade, cooperation in international commodity problems, and a joint approach to other world economic problems."¹⁶⁷ Additionally, a consensus-based decisionmaking process was formalized, allowing the organization to proceed at the pace of its slowest member.

In spite of its lofty intentions, ASEAN made little progress in its first decade, except in the development of limited joint regional security goals. Action in this realm, forced, in part, by concern over conflict in Vietnam and Cambodia, as well as fear of domination by large external actors (particularly the U.S. and Japan), provided the general impetus for later cooperation in other venues.

The first ASEAN summit held in Bali in 1976 was considered by many observers to "mark the emergence of ASEAN as a functioning institution."¹⁶⁸ The summit produced two treaties, the *Treaty of Amity and Cooperation in Southeast Asia* and the *Declaration of ASEAN Concord*, respectively intended to promote a general framework for member relations and greater economic cooperation.¹⁶⁹ More concrete accomplishments included a call for regional joint ventures among private firms, promotion of intra-regional trade through preferential trading agreements, and the creation of an ASEAN Finance Corporation.

Despite the perceived success of the 1976 (Bali) and 1987 (Manila) summits, progress in increasing levels of ASEAN economic cooperation have, until recently, remained weak. ASEAN preferential trading agreements, intended to be operationalized in the form of reduced tariffs, were initially marred by micro-management in the form of product-by-product tariff reduction negotiations. The result was coverage of only five percent of intra-ASEAN trade by such agreements and resulting low levels of intra regional trade.¹⁷⁰ Though improvements were made in this area at the 1987 Manila summit, the frequency of tariffs has remained high (about 80 percent). Average tariff rates have also remained relatively high, at close to 30 percent.¹⁷¹ At least one study thus concludes that past progress in the reduction of tariffs through the program has been "disappointing."¹⁷²

Also, though seven joint industrial projects were approved in 1976, progress has been limited in all but a few.¹⁷³ Relaxation of equity requirements

negotiated during the 1987 Manila summit failed to generate a hoped for "breakthrough" in this area.¹⁷⁴ Unfortunately, successful cooperation in the establishment other cooperative ventures was, to a great extent, overshadowed by the failure of industrial cooperation.¹⁷⁵

Economic cooperation in external negotiations was much more effective. During its first two decades, ASEAN did succeed in acting as a group in negotiations with Australia (over international civil aviation policy) and with the European Community (over trade issues).¹⁷⁶ Further indication of its reputation for success in external negotiations can be demonstrated by the acceptance of ASEAN as a "permanent dialogue partner" in global trade negotiations by the Organization for Economic Development (OECD).¹⁷⁷

Finally, the importance of "invisible" and "unannounced" areas of ASEAN cooperation, stressed by noted Asian specialist Lawrence B. Krause of Brookings, cannot be overemphasized.¹⁷⁸ In a region in which business relationships are often based on personal ties, ASEAN initiatives have specifically provided channels which have improved regional business contacts and thus overall economic cooperation. Organizations such as ASEAN associations of businessmen, bankers, and professionals as well as the ASEAN Chamber of Commerce and Industry, for example, have helped establish a basis for future cooperation which have become increasingly apparent in early 1992.

2. ASEAN Today

During the January 1992 Singapore summit, the process of developing ASEAN economic cooperation gained momentum which seems to continue to grow today. The product of this meeting, The Singapore Declaration of 1992, set a new direction for ASEAN economic policy.

During the summit, in what some experts argue may have been a response to European and North American FTA initiatives, ASEAN heads of government decided to "...further accelerate joint efforts in enhancing intra-ASEAN cooperation..." by adopting a new framework establishing an "...ASEAN Free Trade Area...within a time frame of 15 years beginning 1 January 1993..."¹⁷⁹

Using a scheme based on a Common Effective Preferential Tariff (CEPT), this agreement mandates effective tariffs of zero to five percent for 15 major product groups by 1 January 2008.¹⁸⁰ Other summit initiatives agree to increase levels of intra-regional cooperation and integration in investment/banking, industrial linkages, transportation, communication and agriculture (among others). Though the agreement was weakened by a compromise allowing products to be excluded from individual tariff reductions (if the member country feels that tariff reduction would cause "serious injury" to domestic industries), it remains a major milestone in Asian economic cooperation.¹⁸¹

Clearly ASEAN, as a result of its 1992 summit declaration, is at a crossroads in the development of regional economic integration. Does the

Singapore Declaration, described as a "watershed" by some observers, portend the formation of a true FTA in Asia? Or is such an agreement simply an empty political gesture aimed at forestalling FTA development in other regions? These questions currently remain unanswered. It is clear, however, that three factors are most likely to promote change in ASEAN. These developments, the growing interdependence of export sectors, the growth of foreign direct investment (FDI), and the course of external economic events may have more influence on the future of an ASEAN FTA than the political factors involved in the evolution of the Singapore Declaration alone.

First, though ASEAN countries, in particular, have very similar export sectors (based in part on similar factor endowments), making intra-region trade highly competitive, there is little doubt that levels of trade integration in Asia as a whole are increasing.¹⁸² A recent study by economist Linda Low of the University of Singapore study indicates that 1989 intra-Asia-Pacific trade accounted for 76.6 percent of total trade. More importantly, since 1980, intra-ASEAN trade had increased by 1.8 times and intra-Asia-Pacific trade by 2.3 times.¹⁸³

If trade barriers fall as a result of the AFTA declaration, the above trends will accelerate as formerly domestic-oriented ASEAN countries exploit regional economies of scale and increased comparative advantage. At a minimum, increased levels of intra-regional trade, both within ASEAN and between ASEAN and the Asian newly industrialized economies (NIEs) of Hong Kong, Taiwan, and

South Korea tend to increase regional interdependence and build personal/professional business relationships. Such trends will provide impetus for further integration.

Second, levels of NIE FDI in ASEAN are growing. In some cases, levels of NIE FDI have increased by over twenty times from 1986 to 1990 alone.¹⁸⁴ This fact, coupled with a parallel phenomena, the movement of NIE industry to ASEAN countries by regional multinational corporations (MNCs), will add further incentive for closer economic cooperation between the NIEs and ASEAN countries.¹⁸⁵ These movements can be expected to expand as MNCs look to domestic and regional markets to service relocated industries. Though such trends do not guarantee more cooperative ASEAN relations, they will undoubtedly add to the momentum for closer economic cooperation in the region.

The third factor promoting regional integration does not originate in ASEAN (or even Asia), instead it originates in the drive toward regional integration in North America and Europe.

As argued previously, there is a clear trend towards economic regionalism in North America and Europe. Former ambassador to the Philippines, Stephen W. Bosworth, argues that the of the two, the American decision to negotiate a NAFTA "...has been particularly disconcerting to Asians" because it seems to be a signal of the failure of America to provide critical support for free trade under the GATT system.¹⁸⁶ Many Asian decisionmakers, reflecting the unease created by this move, have begun to feel a move toward closer economic

cooperation in the form of a regional economic grouping is inevitable.¹⁸⁷ This view is echoed by Jeffrey J. Schott, who argues that potential FTA members, in general, "... do not regard FTAs as a complement to GATT negotiations, but rather as a defensive reaction to the threat of protectionism and bilateralism by the United States."¹⁸⁸

The formation of FTAs in Europe and North America may thus be a final determinant of the future of an Asian FTA. Whether or not this is true may depend on the role of Japan. This nation's pivotal role is thus an appropriate subject for consideration in our next section.

3. The Role of Japan

The role of Japan in Asia has changed a great deal since the 1974 visit by Japanese Prime Minister Tanaka touched off civil disturbances in ASEAN countries as a protest against "Japanese encroachment."¹⁸⁹ Since 1977 the role of Japan has been critical to the future of developing Asia.

The initiation of the "Fukuda Doctrine" in 1977 began a new era in Japan-ASEAN relations.¹⁹⁰ Active diplomacy on the part of the Japanese government encouraged the commitment of capital to the region in the form of both loans and aid. Despite a 50 percent appreciation in the value of the yen during the mid-1980s (and the repayment problems that caused smaller Asian economies), Japan played a major role in ASEAN and the NIEs throughout the period.

A "new wave" of Japanese investment in ASEAN actually started in 1986, encouraging the average annual growth rate of Japanese investment to average over 53 percent per annum from 1986 to 1989.¹⁹¹ By 1989 Japanese investment in ASEAN and the NIEs was up to \$7.8 billion, concentrated in labor and capital-intensive industries producing goods for both export and domestic markets. Japanese imports of ASEAN products and raw materials have also been steadily increasing (by 50 percent in 1988).¹⁹² Finally, ASEAN and the rest of developing East Asia remain the focus of Japanese Official Development Assistance (ODA). Such linkages, particularly as American investment in the region remains stagnant, cannot but help to promote economic interdependence.

The advent of the FTA phenomena in North America and Europe has led to a decline in influence in Asia for the industrialized West, making the role of Japan even more significant. According to Congressional Research Service economist Dick K. Nanto, U.S. and European FTAs "...have provided a unique opportunity for Japan to gain leadership in Asia at the expense of the Western industrial powers and for Asian NIEs to rethink their heavy dependence on the United States."¹⁹³ It has also led to fears on the part of Japan of decreased market access due to increased levels of protectionism in the West.

The result of the above has been to make Japan increasingly desirous of a role as the voice of developing Asia. Particularly with respect to the NIEs of Hong Kong, South Korea, Taiwan, and Singapore, Japan has been more and more vocal. Evidence of this Japanese goal was demonstrated as early as 1988 at the

Montreal Summit, with a Japanese attempt to "...stake a claim as the voice of NIEs in Asia."¹⁹⁴ Proposals for a regional economic group in Asia, with Japan at the head, have since continued.¹⁹⁵ Most recently this desire was nominally defined by Prime Minister Toshiki Kaifu during a 1991 Singapore policy speech. In this speech he proposed that Singapore and Japan should serve as "...the indispensable tips..." of the "New Crescent of Prosperity" serving to link Northeast Asia, Indo-China, and ASEAN in the 21st century.¹⁹⁶

Counterbalancing the above trends, it must be realized that, though proposals for a Japan-led regional economic grouping have gained some support in Japan, their support in ASEAN and the NIEs currently does not appear to be strong. The developing countries of Asia continue to fear exploitation by Japan in such a grouping. Additionally, memories of Japanese aggression in WW II, though diminishing as each new generation enters the work-force, are still present.

The particular disincentives above could rapidly change, however, if FTAs become institutionalized in the industrial West and GATT fails. In that case, as Japanese investment in Asia increases and old memories dim, ASEAN and the NIEs might well feel differently about a Japanese role in an Asian FTA. Though it is doubtful that Japan would be accepted as the leader of such an FTA, the simple presence of Japanese economic might would lend enormous weight to the voice of an Asian FTA in international trade negotiations. In addition, such a group would have a combined GNP much closer to that of the EC or NAFTA

(Table VIII), giving the resulting FTA a proportionately greater voice in the definition of international trading relationships.

TABLE VIII.

COUNTRY/AREA	1989 GDP IN MILLIONS OF DOLLARS
AFTA/NIE Total	701,663
Japan	2,865,750
Asia Total	3,567,413

Source: *International Marketing Data and Statistics* 1992, 16th edition (London: Euromonitor, 1992).

4. AFTA Futures

In sum, though ASEAN's ability to promote internal market liberalization appears to be less than perfect, it has, on several occasions, demonstrated both assertiveness and cohesion in international negotiations. The ability to act in a unified manner on international trade issues may be a determining factor in the future of the FTA. Particularly in a trading system where American economic hegemony is declining, if current trends continue, Asia may be feel coerced into the formation of an FTA. If developed, such an Asian FTA would result in substantial interdependence and increased levels of economic integration for Pacific Rim nations.

Though the future of an Asian FTA is impossible, at this point, to accurately predict it appears that the trend in Asia is toward economic integration

and regional trade freedom. As a result of the AFTA agreement, Malaysian economist Mohamed Ariff recently noted:

...trade cooperation has progressed remarkably from the cumbersome item by item approach, starting with just 71 items in 1976, to across-the-board tariff cuts involving tens of thousands of items with a formal commitment and a firm timetable to increase the depth of tariff cuts and shorten the national exclusion lists.¹⁹⁷

He also notes that:

ASEAN countries have built up a cohesive and strong network for consultation and co-operation in major economic policy development without compromising national sovereignty.¹⁹⁸

It is thus appropriate for America to consider policy approaches that address the effects of an Asian FTA on the United States. Even if no formal FTA develops, the trend toward Asian regional integration is likely to continue.

Economist Dick K. Nanto summarizes the trend nicely, arguing:

Whether a formal Asian Pacific Bloc is created or not is, in fact, largely immaterial because a de facto trading bloc is emerging. It is arising out of economic necessity and will continue to grow regardless of the development of a formal free trade agreement among the various economies...¹⁹⁹

If an Asian FTA were completed, it could realistically be the third actor in a global trading system based on an international economic "triad" consisting of the EC, the NAFTA, and the Asian FTA. The first and most essential question to be addressed concerning such a triad is: What type of economic effects would such a system have on the United States? This, the fundamental dilemma facing future American policymakers, will be the subject of the next section.

IV. POTENTIAL ECONOMIC EFFECTS OF TRADING BLOCS

The economic effects that the above FTA-based global trading system will have on the United States are still quite controversial. Because this system has not yet been fully realized, little hard empirical evidence is available. As a result, integration phenomena associated with customs union theory must chiefly be used to predict the future economic impact of the resulting system on America. Fortunately, customs union theories are highly applicable to the examination of regional integration in the form of FTAs, because customs unions are simply a more highly integrated form of FTAs.

Two types of gains and losses, static and dynamic, can be associated with integration theory. Static effects can be defined as "...those stemming from once-and-for-all reallocation of an existing stock of capital, labor, and other resources..."²⁰⁰ Dynamic effects, on the other hand, are "...those associated with the effects of regional economic integration on productive capacity and potential output..."²⁰¹

This section will examine both static and dynamic theories relating to regional economic relationships, using them and available general empirical information on regional trade flows to make some elementary predictions as to the economic effect of an FTA triad on America. To set the stage for the discussion of customs union theory, however, it will first be necessary to briefly

review the gains generally expected from an open multilateral international trading system.

A. TRADITIONAL GAINS FROM INTERNATIONAL TRADE

The most basic benefits from trade among national actors in an open international system center on the acquisition of essential raw materials, the promotion of competition, and the creation of international interdependence.²⁰² The acquisition of raw materials allows nations to produce products and enhance processes that would be impossible using only national resources. Sales of these resources provide benefits to trading partners also in the form of cash return from sales. International competition, on the most general level, promotes the well-being of consumers by allowing greater consumer choice and lower prices. The creation of international interdependence may also be a basic advantage of trade, creating through trading relationships spill-over effects in other economic and political areas of national concern.

The above benefits promote systemic economic efficiency. However, those are not the only potential gains from free international trade. Other, more important processes are also at work.

British economist David Ricardo first formulated the concept of "comparative advantage" over 150 years ago.²⁰³ This theory conceptualizes the advantages gained through national product specialization in terms of the minimization of "opportunity" costs and superior allocation of the factors of production. Thus, in

a theoretical two product/two country world, each nation would gain by producing one product internally and purchasing the other from its trading partner. These savings, realized through national specialization and visible in terms of the reduced opportunity costs of the production of two products, also exist in a broader, multiple-good trading system.²⁰⁴

The creation of comparative advantage is not the only other gain realized from free international trade. Economies of scale can also be created.²⁰⁵ Economies of scale generally occur when specialization, technological innovation, or experience lower production costs and allow more efficient use of the factors of production.²⁰⁶ Though often discussed in terms of a two country system, this benefit too is seen in the open multilateral trading system.

Through the gains discussed above, the value of free trade is realized, making it a "first best solution" for the structure of the international system. Renown economist Paul Samuelson argues that in such a system, "free trade and ideal transfers could give a similar maximal world utility frontier for all individuals."²⁰⁷

Comparative advantage, economies of scale, and other benefits provide the gains associated with an international system based on multilateral free trade. Are there, however, practices that can degrade this system? The answer is yes. Tariffs and non-tariff barriers may inhibit system effectiveness. These national practices will generally decrease the efficiency of the open multilateral system.

Tariffs have both revenue and protection effects which may combine to generally reduce the expected gain from international trade. Though it has been generally accepted that tariffs affect third country suppliers and consumers of protected products, there may also be negative effects on other firms, particularly those exporting products to international markets. In this way, tariffs (and non-tariff barriers) can impose artificial taxes.²⁰⁸ In a similar way, non-tariff barriers generally reduce gains from trade through price, trade, and other market distorting effects.²⁰⁹ These barriers generally take the form of quotas, discriminatory taxes, customs valuations, and increasingly, negotiated variable export restrictions (VERs).

The disintegration of the GATT structure and increases in levels of international protectionism may be making the "first best" solution of an open multilateral trading system impossible to achieve. As argued in the opening chapters, another solution may exist in the formation of free trading areas. Is the FTA alternative a "second best" solution? If so, what impact will such a solution have on America? Discussion of these and related questions will require the consideration of customs union theory.

B. CUSTOMS UNION THEORY-STATIC EFFECTS AND THE GLOBAL TRIAD

Customs union theory as a distinct area of economic analysis dates from the 1950s. In that era, economist Jacob Viner challenged traditional perceptions of

customs union's economic effects and began a formal discussion which continues today.²¹⁰

Viner's central thesis was based on his dispute of the historical argument concerning the benefits of customs unions. This argument, aptly restated by economist Richard Lipsey, asserts that:

Free trade maximizes world welfare; a customs union reduces tariffs and is therefore a movement towards free trade; a customs union will, therefore, *increase* world welfare even if it does not lead to a world welfare *maximum*.²¹¹

Viner and other like-minded economists, by introducing the concepts of trade creation and trade diversion, argued credibly that customs union formation is not:

...equivalent to a move to free trade since it amounts to free trade between the members and protection vis-a-vis the outside world. This combination of free trade and protectionism could result in 'trade creation' and/or 'trade diversion'.²¹²

Focusing primarily on the costs of production, these two concepts revolutionized the economic exploration of customs unions.²¹³

Generally, trade creation is defined as a change in a nation's purchasing habits for a particular product from higher-cost internal (national) source of supply toward lower-cost supply source in a union partner state. It is trade creating in that the first nation is buying goods from a union partner that were previously produced at home at higher cost. This increases economic efficiency by promoting the use of the lowest cost suppliers for a particular good within the union. Alternatively, trade diversion is defined as the replacement of less

expensive products produced externally to the union with higher cost products produced within the union. This decreases economic efficiency because the lowest cost supplier for a particular good is no longer utilized.

More specific definitions address the finer distinctions of economic theory inherent in these phenomena. Economists Augusto de la Torre and Margaret R. Kelly explain:

On the supply side, gains from trade creation most frequently occur as resources previously engaged in costly production for the home market are reallocated to producing exports that enjoy preferential access to other members' markets (intra-union or internal trade creation). Gains may also arise by stimulating the production of exports for the outside world (extra-union or external trade creation). On the demand side, consumers gain from trade creation because of lower prices and a greater variety of goods and services.²¹⁴

With respect to trade diversion they further expound that losses accrue to consumers:

...as imports are now purchased from suppliers within the union that are less efficient than suppliers outside the union. The higher cost of these goods offsets the internal market prices attributable to lower intra-union trade barriers. From the point of view of the member country, this trade diversion means that tariff revenues for the government (or quota rents to importers) are now paid implicitly as subsidy (to) production in other member countries.²¹⁵

Several other effects associated with trade diversion and creation bear mentioning. First, member gains may result from union formation through the creation of natural rents produced by lower trade costs and preferential market access.²¹⁶ Second, depending on the structure of international trade and demand/supply elasticities, trade diversion may improve the terms of trade for

member countries with large world market shares through the reduction of certain transaction costs.²¹⁷ Improvements in the terms of trade then, in a circular manner, diminish the impact of trade diversion. This effect might be particularly important for the U.S. since North American share of world trade is large (approximately 30 percent of total world trade). The gains from this phenomena could provide real economic benefits for the U.S. Finally, trade creation is likely to be high and trade diversion low if tariffs of outside countries are high, tariffs of prospective members are high before union creation, or union formation results in substantial tariff reduction.²¹⁸

It seems obvious on the surface that trade creation is economically desirable while trade diversion is not. Viner essentially concluded that the relative strength of the effects of trade diversion and trade creation determined whether or not a customs union enhanced overall economic efficiency. More recently de la Torre and Kelly echoed Viner's conclusion, stating: "the net impact (of a customs union) is an empirical question and depends on net static and dynamic effects of trade creation and diversion."²¹⁹

Wonnacott and Lutz argue that the distinctions between these two phenomena leads to some initial conclusions.²²⁰ First, increases in levels of internal trade between agreement members do not necessarily reflect the economic success of the union. This is because such effects can be either positive or negative depending their trade creating or diverting tendency.²²¹ Second, because of the potentially trade diverting effects of a preferential agreement

negotiated on partial basis (only certain goods covered), the best agreement is one which covers all products traded by the potential union.²²²

Clearly, based on the above theories, the measurement of the static effects of an international triangle of FTAs (in terms of welfare effects for the U.S.) appears to be best accomplished through the empirical analysis of trade diversion and creation.²²³ Unfortunately, empirical quantification (outside of models) of such effects is not really possible at this juncture due to these groups' stage of development.

The formal "theory of second best," as it applies to customs unions, results from Viner's ideas of trade diversion and creation. It appears to have been first iterated by Richard Lipsey in 1957. This theory postulates that:

If it is impossible to satisfy *all* the optimum conditions (in the case of free trade making all relative prices equal to all rates of transformation), then a change which brings about the satisfaction of *some* of the optimum conditions (in this case a customs union) may make things better or worse (depending on the degree of trade creation/diversion).²²⁴

The concept of second best subsequently came to define customs union theory.

Based on the above theories, some basic observations are possible. To begin, since trade creation/diversion effects are not yet possible to measure, it is clear that if only static customs union theory is considered, that an international system based on an FTA triad system would be a "second best" solution. A solution based on an open multilateral trading system would obviously be "first best."

Unfortunately, because of the failure of the GATT and growing trends toward protectionism in the international system (which many argue are led by

the United States) a "first best" solution may not be realistically achievable.²²⁵ If not, then a system based on regional trade liberalization might provide a viable "second best" alternative. If nothing else a regional relationship might forestall rising protectionism, a possible "third best" solution. At best such relationships might provide an avenue for a return to a more open system by creating confidence in its members of their trading partners' commitment to a international trading system based on free trade relationships.

As a nation dependent on international trade, for the United States a "second best" solution means that some welfare loss in a regionally oriented system is probable. It is important to note, however, that since protectionism does act as an effective tax on all exports, the welfare losses incurred might be somewhat less than those currently imposed through protectionist practices.²²⁶

It is also important to note that the general effects associated with trade diversion and creation may be diminishing as trade becomes more and more international in nature. As geographic borders to trade blur due to the globalization of trade and investment, and as multi-national corporations (MNCs) continue to grow, trade diversion effects are not isolated to specific countries. One example of this trend would be the national corporation which builds its products overseas having its sales diverted by higher-cost partner country production.²²⁷

Trade diversion and creation concepts lead to other important general conclusions. First, trade creation is most likely to outweigh diversion if the potential members are natural trading partners.²²⁸ That is, if the prospective

partners are already major trading partners (share a high the volume of intra-regional trade as compared to external trade), are close geographically, and generally are competitive economically, the gains of trade creation are likely to be high. The first two parts of this idea are relatively non-controversial. It is relatively clear that if a group of countries are already major trading partners then the uniform reduction of tariffs in a customs union scheme is likely to improve terms of trade for all concerned. Likewise, geographic proximity and associated low transportation costs may make tariff reduction via customs union efficiency enhancing.

The third concept is slightly more complicated. This point, originally made by Viner, has often been construed to mean that union partners should be competitive economically to maximize trade creation. The degree of overall competitiveness, though important, is not the whole story. This concept also has a component concerning internal complementarity. This involves the difference between partner country cost structures. If member cost structure for a given protected product are highly dissimilar (complementary), gains from trade creation per dollar of trade in that particular area can be great as the lower cost country exploits its comparative advantage. This does not lessen the argument for overall competitiveness as trade being creating. It simply emphasizes that given trade creation will occur overall (member country costs are at or below world cost levels), gains will be greater if complementarity in a particular product area exists.²²⁹

Though it is not completely possible to discern whether or not the three blocs are "natural" trading partners (based on the available data), a determination of each blocs levels of intra-regional trade and geographic contiguity may give some indication of the propensity for trade creation within each bloc.

In terms of intra-regional trade some interesting specifics come to light. The strength of these relationships may indicate a propensity toward trade creation in all three areas.

Recently in the EC, substantially more trade has been intra-regional than extra regional (Appendix G).²³⁰ Additionally, based on the Cecchini Report, levels of intra-EC trade are expected to increase by five or six percent as a result of the single market.²³¹

In North America, the home of the future NAFTA, intra-regional trade makes up a greater portion of total trade than exports to any other region. In 1989, 63.6 percent of Canadian imports were from the United States and 70.7 percent of Canadian exports were exported to the U.S.. Also, 66.6 percent of Mexican imports were from the U.S. while 63.3 percent of Mexican exports went to the U.S.²³² Such large regional trade statistics, plus the fact that Canada and Mexico are America's first and third largest trading partners, likely have meaning for the discernment of a "natural" trading relationship.²³³

Finally, though the Asia-Pacific's intra-regional flows were the least of the three, they were at least as large as their external (inter-regional) trade flows. They also continue to grow at a faster pace than intra-regional trade in the EC or

North America.²³⁴ Here, 1989 imports of regional origin averaged approximately 35.8 percent among Asian nations while Asian destinations claimed an average of approximately 27.7 percent of exports.²³⁵

Without too much examination it is evident that all three blocs are relatively close geographically. This is particularly true in the case of NAFTA where all three members share borders. It is also generally true in the case of the EC. In that FTA, all current members but Greece share land or close-aboard regional sea borders. Of the potential members with applications pending, only Malta and Turkey are relatively widely separated from their potential FTA partners. In the case of the Asian FTA the condition of geographic contiguity is somewhat less true, however, all of the potential partners except Japan (who may not be a directly participating member anyway) are located in the South China Sea geographic region.

In terms of complementarity or competitiveness, distinctions are difficult to make because of a lack of FTA relative cost data. Despite this lack of data, a look at regional commodity shares of trade calls attention to some noteworthy facts.²³⁶ In the EC a high percentage of exports from all members consists of food and live animals (averaging 13.5 percent), basic manufactures (21.3 percent), and machinery/transport equipment (28 percent). In North America, though food and live animals make up smaller shares, similar trends are seen in basic manufactures and machinery/transport equipment (forming 11.9 and 33.6 percent of exports respectively). ASEAN and the NIEs also share some roughly equivalent

export areas. In particular, high percentages of export commonality can be seen in basic manufactures (13.6 percent), machinery/transport equipment (24.2 percent). Differences do, however, arise in crude materials excluding fuels and miscellaneous/manufactured goods (16.2 and 22.7 percent of export share).²³⁷

Given the industrialized or industrializing state of these potential FTAs, these numbers are not completely surprising. Still, though by no means conclusive, these figures give a preliminary indication of competitiveness within and among these FTAs. Competitive sectors seem to be indicated both within and between potential FTAs.

Clearly more investigation is needed, particularly in the form of sector and product cost structure evaluation, to make positive conclusions as to the static effects of the hypothesized trilateral system of FTAs. However, because of the size and structure of existing trading relationships, general geographic contiguity, and seemingly competitive internal markets, an initial judgement that trade creation may predominate in such a system is not unwarranted. Certainly it cannot be definitively stated, based on existing data concerning static effects, that an FTA triad system will be inevitably be trade diverting. Consequently, possible dynamic effects of an FTA system must next be investigated to see if any potential negative effects appear.

C. DYNAMIC EFFECTS AND THE GLOBAL TRIAD

The preceding discussion generally addressed only static or one-time effects of customs unions. Dynamic effects may also occur. Such effects operate through economies of scale, spillover phenomena, competitive relationships, investment climate changes, rates of technological change, and consumption "smoothing."²³⁸ These effects also bear discussion.

Of particular interest are economies of scale, which can have both static and dynamic effects. A thesis advanced by Wonnacott and Lutz argues that economies of scale may be more important than Viner allowed. This is because economies of scale may make it possible for even a trade diverting union to promote economic efficiency by allowing members open access to larger markets than were available prior to union formation. Particularly if non-tariff barriers were a factor prior to union formation, this can promote trade even if overall union effects seem to be trade diverting.²³⁹

These effects operate two ways.²⁴⁰ The first is through the firm where lower costs and increased productivity allow firms that previously operated below efficient levels to expand output and move down their cost curves. The second is industry-wide, where spillover effects and other externalities promote cost reductions.

The potentials associated with such scale implications could mean that even trade diverting FTAs might promote economic gains as a nation's firms use economies of scale to parley internal FTA competitiveness into competitiveness

in the greater international system. The result would be lower cost goods for not only its own members but the other actors in the international trading system as well. Economist Ali El-Agraa adds that, in principle:

In unions where economies of scale may be in part external to national industries, the rationale for unions rests upon the recognition of the externalities and market imperfections which extend beyond the boundaries of national states. In such circumstance, unilateral national action will not be optimal whilst integrated action offers the scope for potential gain.²⁴¹

In both these cases, gains for the international system would likely result in benefit gains for the United States as well.

Economies of scale and their associated spillover effects (such as improved direct knowledge transfer) can also lower costs and increase productivity in a more traditional manner by increasing levels of competition, improving the international investment climate, increasing the pace of technological change, and reducing economic uncertainty. Competition provides relative price reliability which increases market transparency and lowers prices. It also helps spur technological improvements. Stability related improvements in the international investment climate provide gains through investor confidence-building and increased commitment reliability. Such improvements also increase the ability of entrepreneurs to reap the rewards of innovation. Here again it is possible for both the international trading system and America to benefit.

Consumption smoothing requires some brief discussion. This phenomena concerns the effects created by unrestricted access to world markets and the ability of actors to compensate for fluctuations in the business cycle. A related

idea, initially argued by Lipsey, concluded that trade diverting customs unions may have the effect of lessening distortions in patterns of consumption, thereby compensating for negative trade diversion effects.²⁴² Benefits realized by reduced trade diversion may improve efficiency in the global trading system. Positive benefits for the U.S. could be based in these effects as well.

D. OTHER EFFECTS AND THE GLOBAL TRIAD

Other potential external effects of a customs unions bear some mention. These effects are based in the phenomena described by a non-tariff barrier argument, a unified action argument, various political arguments, and most importantly, a system openness argument.

The non-tariff barrier argument emphasizes that the "...replacement of tariffs with quantitative restraints over the last several decades has muddled the analysis of trade diversion; it has provided another reason why trade diversion need not be bad." This is because quantitative restrictions may have previously restrained a nation's low cost partner from supplying internal markets. When quantitative restrictions are dropped as part of FTA liberalization, the lowest cost producer reenters the national market and economic efficiency is promoted. Such cost minimization benefits would likely benefit the FTA, negate some trade diversion, and provide gains for the international system. Given the high proportional use of non-tariff barriers by the U.S., such a phenomena could benefit this country.

Simply stated the unified action argument asserts that nations acting together are more likely to exert an external influence than nations acting alone.²⁴³ A group of nations is also able to negotiate from a stronger bargaining position. Such an argument would seem to provide support for the efficiency of an FTA for America. Indeed this effect has been observed in EC actions to improve its terms of trade over the years.²⁴⁴ However, because of the possibility of joint retaliation by other groups of nations, the effect of this phenomena in a triad system is indeterminant until empirical data is available. Thus, it is impossible to predict effects of an EC, NAFTA, and Asian FTA triad on America in terms of this economic event.

Political arguments also have potential economic impacts on FTAs. First, it has been proposed that because of the current difficulties in multilateral trade negotiations such as GATT, an FTA triad might eliminate "convoy," "free rider," and other multilateral political problems. For the U.S., these political occurrences create potentially large negative economic effects in a number of areas. If such barriers could be eliminated through a triad based system of FTAs the U.S. would clearly be better off. Such positive effects may be likely if the preliminary success achieved by negotiations such as the 1989 U.S.-Canada Free Trade Agreement and the January 1992 U.S.-Japanese Structural Impediments Initiative (SII) talks are any guide.

A second political argument, that an FTA triad will negatively impact the future of vital "strategic" industries, is less well defined. Obviously, if a global

system of FTAs resulted in the loss of certain American industries (like submarine and combat aircraft manufacturing), it would have negative implications for the U.S.. However, such an outcome is not likely in the short term due to clear American technical advantage in many of these areas. In the long term, even if such an unlikely outcome was achieved, the retention of such industries is not best served through protectionist or isolationist measures either in or out of a global FTA system. Rather, such industries would be better protected (from an economic point of view) by subsidization of essential levels of production. This would have direct benefits for the affected industry which protectionist measures could not hope to achieve.

The critical open system argument asserts that substantial trade diversion may occur, distorting comparative advantage, diverting FDI from external projects, and ultimately driving non-members from the market if a "fortress" mentality develops in any customs union.²⁴⁵ Such a mentality could result in the erection of high external tariffs and non-tariff barriers. This effect would, according to de la Torre and Kelly, "...have large negative effects on world GDP, on most countries, and on all regions, including the region that increases protection."²⁴⁶

Clearly the degree of openness in a customs union or an FTA *can* make a difference. If external discrimination is low, tariff reductions resulting from trade liberalization might benefit non-members through previously mentioned concepts of economies of scale and their associated spillover effects.

An ongoing study by economists Murray Kemp and Henry Wan Jr. gives a degree of certainty to the above thesis concerning system openness in noting that:

...there exists a common tariff vector which leaves world prices, and therefore the trade and welfare of non-members, at their pre-union levels. If the net trade vector of the union is viewed as a (constant) endowment, it is then plausible that both the union as a whole and (after appropriate internal transfers) each member must be left not worse off by the removal of internal barriers to trade.

Kemp and Wan add that the above proposition:

...implies that an incentive to form and enlarge customs unions persists until the world becomes one big customs union, that is, until world free trade prevails.²⁴⁷

What this essentially means is that, if FTA barriers remain at their pre-union levels after FTA formation, then international actors external to the FTA are not made worse off by the FTA. Instead, they may be left better off depending on the degree of increase in total trade with FTA members (and relative price differentials) after union formation.

It must be noted that these propositions are closely related to what can be called a "market access" argument. These state specifically that the degree of outward orientation of a customs union in terms of external tariff levels is what determines its effect on the rest of the world. That open and outwardly oriented economies grow more rapidly has been repeatedly proven in the case of developing countries.²⁴⁸ Presumably these effects are translatable to FTAs as well.

A final point relates to this argument. It is important to remember that a free trade area does not normally presume or require common external trade policy as does a customs union.²⁴⁹ This difference is important in terms of an FTAs ability to minimize trade diversion problems. By retaining the ability to independently lower tariffs, the FTA member retains the ability to ensure the use of the most efficient supplier of specific products from the world market. Though having the possible negative effect of reducing the value of its FTA trade concessions, retention of this capability provides a great measure of flexibility not found in customs unions. Further, because external policies are based on differing member policies, an FTA is less likely than a customs union or common market to implement tariffs (or other barriers) that create distortions in the global trading system.²⁵⁰

As of this writing, no modelling has been done specifically on the openness issue in terms of FTA systems. However, one model, developed by economists Glenn W. Harrison and E.E. Rutstrom, examined the results of a trilateral trade war between the U.S., the EC, and Japan.²⁵¹ Though highly subject to the entering assumptions, this model concluded that GNP would fall steeply in all countries except the EC and the U.S. when high barriers were imposed "across the board" by all three actors. Though the U.S. and the EC were seen to gain on balance from the trade war (subject to certain assumptions) the international system was clearly worse off. Also, other nations in the world would have significant incentive to retaliate against the three main actors to eliminate any gains.

Though the above study cannot be directly linked to our discussion of regionalism, some inferences can clearly be drawn for a system based on an economic triad. The study seems to confirm that the hostile imposition of tariffs in a trilateral system can be highly damaging. This drives home the point hypothesized by economists that the economic success of an international system anchored by three FTAs is critically determined by its ability to retain existing external barriers or impose lower ones. It seems that no other single fact is as determinant for the future of an FTA-based system.

E. SUMMARY OF FTA ECONOMIC EFFECTS

Viner's conclusions regarding trade diversion and creation, though critical to the formulation of general customs union theory, may not account for all of the static and dynamic effects present in a modern international system based on three large Free Trade Areas. Mitigating effects, including the initial structure of international trade, the nature of FTA member relationships, economic factors, political realities, and, most critically, resulting system structure may combine to minimize any negative effects of trade diversion.

V. CONCLUSIONS AND POLICY RECOMMENDATIONS

A. CONCLUSIONS

America has a historical tradition of reliance on trade as the economic foundation of its domestic well-being. Because of this fundamental reliance on access to the international marketplace for its exports, the future of international trade regulation mechanisms has serious national security implications.

It has been demonstrated that the General Agreement on Tariffs and Trade, the paradigm used to regulate international trade since shortly after World War II, is failing. Disagreements on agricultural reform, trade in services, intellectual property rights, and enforcement mechanisms prevent compromise between the agreement's most influential signatories. Institutional problems and a changing international order exacerbate the agreement's failure. As a result, ongoing Uruguay Round negotiations, conducted under GATT auspices in Geneva, are unlikely to succeed. More importantly, even if talks do result in a weakened compromise agreement, GATT may remain unable to control the course of future international trade. Because America's vital national interest in trade appears to be threatened, such a failure clearly creates an important problem for American policymakers.

Because of the failure of GATT, the international conditions necessary to ensure the survival of multilateral free trade, seen by most economists as a "first best" choice for global trading relationships, may no longer be assured. The most visible response of the international system has been to place increased emphasis on regional trading arrangements. The European Community, the North American Free Trade Area, and a fledgling Asian Free Trade Area appear to be the largest, and to date, the most successful, of these developing regional organizations.

Analysis of the potential economic effects of these developing FTA relationships makes clear the difficulty of predicting any results in advance. Obviously, the effects of such a system cannot be predicted with absolute certainty without post-formation empirical data. Nevertheless, fundamentally positive economic effects, based in gains from economies of scale and efficiency increases, do appear to be possible. Though these effects are "second best" when compared to a multilateral system of free trade, they are clearly more productive than an international trade regime based on unilateralism.

The potentially positive economic effects of a triad system are, however, tied to the certain natural geographic and economic factors as well as the critical measure of the size and depth of FTA external barriers. Clearly, if external barriers are either maintained at the status quo (or lowered) in such a system, a regionally oriented system *cannot* be condemned based on the data that currently exists. In fact, if openness is truly institutionalized in such a system, then it could

have overall positive effects through the economic gains associated with the creation of scale economies. Such a system could, in fact, provide ultimately beneficial economic results for the United States.

Perhaps more importantly, this research has highlighted the fact that regional integration in the form of FTAs may, if properly pursued, provide a viable alternative path to international trade liberalization under GATT. Such a dynamic outcome, if realized, would clearly make a regionally based system in the short term best interests of both the United States and other international actors, particularly as GATT fails. Preliminary results are encouraging. For that reason alone they are worthy of consideration in the U.S. policymaking process.

Continued empirical research into all of the economic effects of a global trading system based on three large FTAs is needed. Moreover, until solid empirical data is gained from the actual operation of a trilateral global system no *absolute* conclusions can be formed. But, given the fundamental economic theory on FTA formation, and considering the available empirical data, no specific economic aspect of an international economic system based on a few large FTAs makes it inherently unsuitable for use as a secondary framework for international economic relationships. This conclusion has clear implications for American policy decisions.

B. POLICY RECOMMENDATIONS

Free Trade Areas are clearly a "second best" solution when compared to multilateral free trade. Since this fact is beyond challenge, American trade policy should acknowledge that a consensus driven "first best" solution based on multilateral free trade remains the most desirable outcome of the ongoing Uruguay Round of GATT negotiations. Thus, in the short term, the continued pursuit of a successful conclusion to the Uruguay Round of GATT negotiations is an appropriate primary policy goal for America.

However, the recognition that regional trade regimes have economic viability as an alternative to GATT-based trade management allows the U.S. greater negotiating freedom than has previously been available. As a consequence, the U.S. representatives to Uruguay Round negotiations must remain firm in maintaining U.S. demands in GATT negotiations. That is, they must continue to emphasize the importance of implementing strict rules regulating agricultural subsidies, the creation of a solid regime for the regulation of trade in services, standardized intellectual property rights, the limitation of non-tariff barriers, and the creation of an effective dispute settlement/enforcement process. Concession based negotiations with the EC should thus be discouraged and a firmer policy line should be emphasized.²⁵² Failure to conclude the Uruguay Round (or, at best, an inadequate agreement) would be the likely outcome.²⁵³

This short term policy plan will not, however, be sufficient to sustain America in the future. A GATT failure is not an occasion for rejoicing by even the

most inwardly focused American. Some structure must be created that is capable of effectively managing world trade in the coming years. As a result, a new policy approach must be created to guarantee America's essential economic interests in the longer term. Three basic policy alternatives are available and all are worthy of brief consideration.

A first possibility might be for the U.S. to become more isolationist, narrowing its focus to concentrate only on the domestic economy and the development of trade regulating mechanisms within the context of a closed NAFTA system. Such a policy choice, however, would neglect both the leadership role played by America in the global economy (which though diminished is still vital) and the importance of establishing favorable trading relationships for the approximately \$369 billion in American exports (77 percent of total annual exports) that are traded with nations outside of North America. Isolationism is not a viable policy option.

A second policy choice could involve a shift in national priorities toward an open NAFTA as the sole trade regulating structure for the United States. Any effort to revitalize the GATT process would thus be abandoned (or at least marginalized by decreased American interest in a successful outcome) and full emphasis would be placed on expanding the membership of the NAFTA structure. The most intractable problem with this approach would be the difficulty of negotiating the entrance into NAFTA of other, extremely diverse, national economies. Yet, because of the external trade orientation of America, the

inclusion of a large number of international actors would remain fundamentally important to American exporters. If their entrance was negotiated multilaterally, NAFTA would likely come, in time, to resemble GATT (with all of its problems in achieving consensus). If, on the other hand, their entrance was negotiated only in terms of a limited agreement between the subject country and current NAFTA partners, the possibility that resentment would be created among other members as each country received a "tailored" deal would be so great as to make eventual fragmentation probable. For these reasons this policy option seems unworkable as well.

A third and final policy approach seems to provide the most appropriate American response to the current trend toward economic regionalism. This idea is based on a dual track approach for the U.S trade policy, emphasizing a commitment to revitalize the GATT structure and at the same time, a resolve to sustain the ongoing drive toward the development of a regionally-based trade management regime. Such a solution would acknowledge the inherently complementary nature of global and regional trade management organizations and, at the same time, combine American trade policies that are currently separate and distinct into a coherent policy platform.

Under this policy umbrella, significant changes to GATT would be proposed. First among these would be a review of Article 24, the GATT article governing regional trading relationships. It would be urged that this article be clarified so as to more fully define the requirements for a GATT-consistent regional trade

association.²⁵⁴ Other changes would be included. The most important among them would be an firm effort to replace the weak, consensus-based GATT decisionmaking process with a majority based system of decisionmaking. This evolutionary step is vital if GATT credibility is to be restored.

The creation of a GATT Regional Council would also be proposed, with membership consisting of representatives from all Article 24 compliant FTAs. The new regional council of GATT might have several important features. First, it could be given a mandate to consider innovative solutions to the "most difficult" trade policy issues associated with agriculture, textiles, services, and dispute settlement procedures. Such a mandate might allow the translation of innovative solutions to the these difficult problems that were negotiated on a regional basis to be translated to the international arena. Second, it could, by promoting majority rule decisionmaking, by limiting each regional association to one vote, and by forcing FTA compliance with Article 24 rules promote more rapid decision implementation. Such a council might play an effective role in GATT as a negotiating forum for the representatives of growing regional economic groupings.²⁵⁵

Pursuit of an regional approach toward the management of North American trade (presumably based on the current NAFTA proposal) would also continue. This policy approach would, even more than it does at present, emphasize complete compliance with Article 24 regulations. However, instead of being a separate and distinct policy initiative as it is at present, NAFTA would form a

valuable second tier of U.S. trade policy. This policy change would send the message to GATT negotiating partners that the U.S. would accept the "second best" alternative provided by regional FTAs in the event of that GATT revitalization was unsuccessful. Such a policy stance might well convince America's negotiating partners in GATT to be more conciliatory on previously insurmountable issues. It also would also clearly ensure that the U.S. maintained an effective fall-back regional trade management regime in the event of the total collapse of the GATT revitalization effort.

The above policy approach would require that the United States once again assume an aggressive leadership role in the global economy. Given the potentially positive economic effects of FTAs previously discussed, however, this may not be such a risky policy proposition. Further, such an approach would not require the massive commitment of funds or the granting of concessions that currently characterize U.S. trade policy. It simply requires a credible public commitment to pursue radically different policy alternatives.

That such an initiative eventually would become a coercive process even for the U.S. is without doubt. However, the alternative, the establishing of a "third best" world trading system as GATT falters appears to be even less attractive. For this reason this policy approach is the only practical alternative for continued American economic leadership in the global economy.

The development of such a structure will require concentrated negotiation between international actors and institutions, as well as continued

research to find the correct structural format. Also, it must be admitted that such radical restructuring does not lend itself to full evaluation prior to its imposition. However, with intelligent innovation along the way, such a combined approach might realistically provide the credible infrastructure necessary to manage international trade in the future. Such an outcome would clearly help make the global economy, now in crisis, both more stable and productive. Regional agreements would thus provide an essential catalyst for the creation of future economic growth. America's essential trading links will be preserved and a more inclusive global economic structure based on international economic reciprocity will have been created. America's security, both economic and political, would be enhanced.

ENDNOTES

1. Louis J. Murphy, "Uruguay Negotiators Overcome Stalemate," *Business America*, 25 March 1991, p. 26.
2. Other organizations, the Organization for Economic Cooperation and Development (OECD), the United Nations Conference on Trade and Development (UNCTAD), the Customs Cooperation Council, and others also manage components of international trade. However, because they do not fill as central a role in overall trade management as the GATT, and because of space limitations, these organizations will not be fully considered.
3. Franklin R. Root, *International Trade and Investment*, 6th ed. (Cincinnati: South-Western Publishing, 1990), p. 193.
4. It is interesting to note, as has Tamotsu Takase, that practically all geographically contiguous and adjacent developing countries have formed or are in the process of forming regional trading agreements. He particularly notes that factors contributing to this process seem to include the development of transport and communication networks as well as commonality in political and economic systems. He finally notes that common historical and cultural backgrounds, cultural homogeneity that is, seem to make the process both quicker and longer lasting. See: Tamotsu Takase, "Different Tariff Treatments and the Uruguay Round," *The World Economy*, September 1988, p. 361.
5. Due to space limitations, the influence of other international organizations on the world trading system is not fully explored. Organizations such as the Group of Seven Industrial Nations (G-7), the Asian-Pacific Economic Cooperation Organization, the Organization of Petroleum Exporting Countries (OPEC), and others too numerous to mention individually exert some influence on world trade. Further, the role of these organizations will obviously be critical in the future. However, any discussion of such organizations in a system without GATT can only be conjectural. Also, since their intent is to serve only specific groups such as industrialized nations, developing nations, or oil producing nations respectively (to name a few) their influence may be limited. Consequently, areas of potential influence for these groups will be explored only on a limited basis relating to their importance to future regional trading systems. Detailed structural analysis of these organizations and their future development is beyond the scope of

this paper and will not be performed. Such analysis will be left to future research.

6. The director of the prestigious Economic Strategy Institute, Clyde Prestowitz, has recently argued that the world trading system is "eroding" and that attempts to negotiate new life into the GATT structure through the ongoing Uruguay round of negotiations was only an attempt to "...apply the failing GATT doctrine even more broadly." Prestowitz further argues that the world may be evolving toward a structure of trading agreements based on regional Free Trade Areas (FTAs). Additionally, in the absence of a strong GATT, as regional cultural homogeneity expands due to wider immigration, improved transportation, and better communications, the propensity for regions to cooperate within FTAs will increase. Others argue that the GATT must be adapted to the changing global trade environment. For more information see Clyde Prestowitz, "Life After GATT: More Trade is Better Than Free Trade," *Technology Review*, 24 April 1991, p.24. and Michael Aho and Johnathan David Aronson, *Trade Talks: America Better Listen* (New York: Council on Foreign Relations Inc., 1985), p.164.
7. Based on the analysis of EC, NAFTA, and ASEAN evolution it will be assumed that the formation of these three blocs is inevitable. With that key criteria in mind, the potential economic effects of these blocs on the United States can be explored. For comprehensive information on the numerous other evolving FTA relationships worldwide (and a complete list) see Norman S. Fieleke, "One Trading World, or Many: The Issue of Regional Trading Blocs," *New England Economic Review*, May/June 1992, pp. 3-19.
8. This thesis will not attempt to determine the relative merits of trading blocs as a group. This is because, although many such areas might be assumed to be in development, only three are mentioned, those that might have significant impact on the U.S. economy in the near future. Some qualitative judgements concerning trading blocs will necessarily be made. However, it is not the purpose of this research to fully explore the positive or negative effects of FTAs on the entire international system. Such judgements would require much greater research (and a far longer document). For the same reasons this thesis will not directly address the impact of EC and ASEAN intra-bloc relations on each other, the U.S., or any other part of the global economy.

Note: An EC-ASEAN cooperation agreement was signed in 1990. See the *Annual Report of the Standing Committee 1990-1991* (Jakarta: The ASEAN Secretariat, 1991), p. 130.

9. In keeping with the macroeconomic orientation of this paper, certain subjects will not be discussed. These include details of individual states propensities to seek FTA membership, functional details of individual FTA member states trading systems, barter/black-market arrangements, and other highly specific details of the global economic structure. Detailed analysis of these sorts of issues would serve to confuse the central questions explored in this document.
10. Jeffrey J. Schott, *More Free Trade Areas?* (Washington, D.C.: International Institute for International Economics, 1989), p. 16.
11. Dr. El-Agraa emphasizes the difference between FTAs and customs unions (in which members pursue common external commercial relations), common markets (which are customs unions that allow factor mobility across national member frontiers), complete economic unions (which are common markets that have unified monetary and fiscal policies, and complete political integration. For this paper, alternative terminology used to define regional economic organizations will be defined as variations of customs unions differing only in degree from less protectionist—the FTA—to more protectionist—the RTB. See Ali M. El Agraa, *International Economic Integration* (London: Macmillian Press, 1988), p. 1.
12. Additional defining characteristics will be the inclusion in the structure of formal dispute settlement measures and an appropriate timetable for implementation of the FTA.
13. Richard S. Belous and Rebecca S. Hartley, "Regional Trading Blocs: An Introduction," in *The Growth of Regional Trading Blocs in the Global Economy*, eds. Richard S. Belous and Rebecca S. Hartley (Washington, D.C.: National Planning Association, 1990), p. 6.
14. Trade expert Clyde Prestowitz, one of many to echo the same opinion, recently noted that "the trend towards regionalism will probably accelerate." See: Prestowitz, p. 26.
15. Richard Tropp, "Seizing the Opportunity Presented by LDC Blocs," in *The Growth of Regional Trading Blocs in the Global Economy*, eds. Richard S. Belous and Rebecca S. Hartley (Washington, D.C.: The National Planning Association, 1990), p. 102
16. Rudiger Dornbusch, "Dornbusch on Trade," *The Economist*, 4 May 1991, p. 67.

17. Peter Morici, "Regionalism: Motivations and Risks," in *The Growth of Regional Trading Blocs in the Global Economy*, eds. Richard S. Belous and Rebecca S. Hartley (Washington, D.C.: National Planning Association, 1990), p. 132.
18. Jagdish Bhagwati, "United States Trade Policy at the Crossroads," *The World Economy*, December 1989, p. 470.
19. Aho and Aronson, p. 124.
20. John Pinder, *European Community: The Building of a Union* (Oxford: Oxford University Press, 1991), p. 60.
21. Other catalysts, most particularly the inability of the gold-based international monetary system to control international monetary balances, also played a significant role in the instability of this era. See: H. W. Arndt, *The Economic Lessons of the Nineteen-Thirties* (London: The Royal Institute of International Affairs, 1944).
22. The League of Nations Economic Survey of 1932-1933 reports that the Smoot-Hawley Act was the incentive for an outburst of reprisal-oriented tariff making led by Canada, Cuba, Mexico, France, Italy, and Spain. See Root, p. 216.
23. Aho and Aronson, p. 15-16.
24. Michael Hart, "A North American Free Trade Agreement: The Elements Involved," *The World Economy*, March 1991, p.102. Also see Franklin R. Root, p. 216.
25. Prestowitz, p. 24.
26. These organizations, created in December 1945 under a series of agreements known as the Bretton Woods System, were based on convertible exchange rates (with the US dollar or gold as its standard) that were intended to bring stability to world financial markets. The organizations discussed helped provide the stability necessary to permit the initiation of trade talks. The Bretton Woods System disintegrated in 1971 to be replaced by floating exchange rates. For more detail see Franklin D. Root, *International Trade and Investment* (Cincinnati: South-Western Publishing, 1990), pp. 458-485.
27. Richard S. Belous and Rebecca S. Hartley ed., *The Growth of Regional Trading Blocs in the Global Economy*, (Washington, D.C.: National Planning Association, 1990), p. 1.

28. Charles I. Bevans ed., *Treaties and Other International Agreements of the United States of America 1770-1949*, Vol. 4 (Washington, D.C.: Department of State Publications, 1970), p. 640.
29. Alan J. Day ed., *Treaties and Alliances of the World*, 4th ed. (London: Keesing's Reference Publications, 1986), p. 45-46.
30. Ibid, p. 46.
31. The US failed to participate primarily because of business pressure and congressional opposition. This negative opinion forced the Truman administration to withdraw the treaty from the ratification process three years after initial agreement. See: Aho and Aronson, p. 15; Belous and Hartley, p. 1.
32. *Treaties and Other International Agreements*, p. 641.
33. Root, p. 195.
34. A. Leroy Bennett, *International Organizations: Principles and Issues*, 5th ed. (Englewood Cliffs: Prentice-Hall, 1991), p. 272.
35. This means that all member nations must receive the most favorable customs duty (lowest tariff authorized) from other member trading partners in any exchange.
36. Some highlights include:
 - transparency and reciprocity requirements
 - general exemptions for developing countries
 - retaliation requirements
 - safeguard procedures (special actions intended to temporarily protect threatened industries)
 - escape clauses
 - enforcement mechanismsFor greater detail and agreement text see *Treaties and Other Agreements* pp. 640-688. For a concise summary of specifics see Root, pp. 195-197.
37. Aho and Aronson, p. 17.
38. Belous and Hartley, p. 15.
39. Prestowitz, p. 28.

40. The Council normally prepares annual meeting agendas for the Secretariat as well as appointing various designated committees and working parties to study specific issue areas.
Note: GATT's actual administrative work (primarily internal staff work and scheduling functions) are carried out by a small professional staff of approximately 200 individuals.
41. Semiconductors, agricultural products, and textiles are only a few examples. For specifics see Prestowitz, pp. 24-26 or Aho and Aronson, pp. 59-76.
42. Prestowitz, p. 25.
43. Belous and Hartley, p. 10.
44. Harold K. Jacobson, *Networks of Interdependence* (New York: Alfred A. Knopf, 1984), p. 248.
45. Aho and Aronson, p. 82.
46. Andrew Elek, "The Challenge of Asian Pacific Cooperation," *Pacific Review*, Vol. 4, no. 4 1991, p. 323.
47. Anthony Rowley, "Window of Opportunity," *Far Eastern Economic Review*, 9 January 1992, p. 35.
48. Aho and Aronson, p. 39.
49. Ibid, p. 106-108.
50. Czechoslovakia was a founding member of GATT. Other Eastern European nations including Poland (1967), Romania (1971), and Hungary (1973) joined prior to the collapse of communism in Eastern Europe. China began negotiating for membership in 1991.
51. Leah Haus, "The East European Countries and GATT: the Role of Realism, Mercantilism, and Regime Theory in Explaining East-West Trade Negotiations," *International Organizations*, Spring 1991, pp. 163-182
52. For the US: from 59 percent in 1932 to 25 percent in 1946, then to 9.9 percent at the end of the Kennedy Round in 1967. See: Jacobson, p. 247.
53. Aho and Aronson, p. 38-40.

54. Protectionist moods in the US Congress later actually led to difficulties for trade negotiators and administration officials attempting to ratify Kennedy Round accords. This directly motivated later "Fast Track" legislation included in the Trade Act of 1974. "Fast Track" was intended to limit the ability of Congress to delay or modify potential trade agreements. Many feel it has been relatively successful.
55. Aho and Aronson, p. 18.
56. See Enzo Grilli, "Macro-Economic Determinants of Trade Protection," *The World Economy*, September 1988, p. 322. It is worth noting that the passage of the controversial 1974 U.S. Trade Act provided a major catalyst to the beginning of this round (because of its protectionist leanings).
57. Jacobson, p. 248. Note: Non-tariff codes of conduct included agreements concerning: customs valuation regimes, government procurement policies, import licensing, subsidies and countervailing duties, and technical barriers and standards.
58. Reductions in industrial tariffs were worth approximately \$155 billion in 1977 dollars. See: Root, p. 201 and Aho and Aronson, p. 19, p. 97.
59. Mainly in the form of voluntary export restrictions (VERs) and other non-tariff measures. See Root, pp. 204-206
60. Ibid, p. 20-21. Note: Minor breakthroughs were in dispute settlement procedures, safeguard protection, the establishment of an agricultural committee, agreement to study certain issues further (services, counterfeiting, textiles, and exchange rates), and agreement to review Tokyo Round non-tariff barrier codes for adequacy.
61. Ibid, p. 22.
62. *United Nations Yearbook 1986*, Vol. 40 (New York: United Nations Department of Public Information, 1986), p. 1210.
63. These included disputes over the implementation of rules concerning emergency import protection, subsidies, non-tariff barriers, agriculture, textiles, steel services, high tech investment, and intellectual property.
64. A dualism in US policy toward GATT was not really new. Historically, America had been the first to request a waiver (for agriculture in 1955). The US was also a primary supporter of the Multi-Fibre Arrangement (MFA), basically a protectionist exemption for certain textile sectors. See: Jagdish

Bhagwati, "United States Trade Policy at the Crossroads," *The World Economy*, December 1989, p. 463.

65. Aho and Aronson, p. 3.
66. Ibid.
67. H.B. Junz and Clemens Boonekamp, "What is at stake in the Uruguay Round", *Finance and Development*, June 1991, p. 12.
68. Louis J. Murphy, "Uruguay Round Negotiators Overcome Stalemate," *Business America*, 25 March 1991, p. 26
69. Junz and Boonekamp, p. 11.
70. Keith Bradsher, "Trade Proposal Draws A Lukewarm Response," *The New York Times*, 13 January 1991, p. C2.
71. Steven Greenhouse, "US Sees Shortcomings in Europe's Farm Plan," *The New York Times*, 27 May 1992, p. C2.
Note: The EC compromise plan, which included sharp cuts in agriculture subsidies, production ceilings, and import barriers, drew the immediate vocal protest of Europe's 10 million farmers (principally in France, Germany, and Italy).
72. Keith Bradsher, "US Hope Dashed on Global Trade," *The New York Times*, 22 October 1992, p. A1.
73. Anthony Rowley, "Window of Opportunity," *Far Eastern Economic Review*, 9 January 1992, p. 34.
74. The coalition includes not only the United States but also others. Other supporters include primarily the "Cairns Group" of Argentina, Australia, Brazil, Canada, Chile, Colombia, Fiji, Hungary, Indonesia, Malaysia, New Zealand, the Philippines, Thailand, and Uruguay.
75. Sylvia Ostry, "The Uruguay Round: An Unfinished Symphony," *Finance and Development*, June 1991, p. 16.
76. Murphy, p. 27.
77. Rowley, p. 35.
78. Murphy, p. 27.

79. Alan Riding, "Europeans Agree on Farm Cuts," *The New York Times*, 22 May 1992, p. C1. Note: As of November 1992, the protests of the French appear to have dominated EC policymaking with respect to GATT.
80. Aho and Aronson, p. 24.
81. Ibid, p. 25.
82. Jagdish Bhagwati, "Multilateralism at Risk: The GATT is Dead, Long Live The GATT," *The World Economy*, June 1990, p. 153.
83. Ibid, p. 30.
84. It is worthy of note that, depending on the source, experts estimate that up to 95 percent of world trade is not covered by GATT. See Schott p. 9.
85. The dispute settlement process is prone to delaying tactics and blocking maneuvers as a result of consensus-based decision making requirements. Without an active and powerful enforcement body GATT will be unable to control these problems. For more see: Schott, p. 7.
86. Protectionist actions on the margins of GATT have, in the past, included the Voluntary Export Restrictions (VERs) imposed by the United States on Japan in retaliation for perceived "dumping" of Japanese products below cost on the American economy. Though VERs are being addressed on some levels by GATT, history shows that nations will be infinitely creative in dreaming up other protectionist measures to circumvent GATT. Adequate enforcement mechanisms are fundamental to the control of this problem.
87. Ostry, p. 17.
88. Prestowitz, p. 24.
89. *Treaties and Other Agreements*, p. 672-673.
90. Herbert E. Weiner, "America's Role in the Founding of the European Community," in *The Growth of Regional Trading Blocs in the Global Economy*, eds. Richard S. Belous and Rebecca S. Hartley (Washington, D.C.: National Planning Association, 1990), p. 57.

Note: Many believe that support of a customs union concept was undertaken not only to aid in the re-industrialization of Europe but also to offset growing Soviet influence in Europe.

91. The six original members of the ECSC were: France, West Germany, Italy, Belgium, the Netherlands, and Luxembourg. Britain did not join for fear of domination of its domestic industry by foreign governments (visions of its role as a world power may have also played a part).
92. Ibid, p. 61.
93. Original EFTA membership included Britain, Denmark, Norway, Sweden, Austria, Switzerland, and Portugal. Finland and Iceland later joined.
94. The problem of full integration of the EFTA into the EC has only recently been solved with the 22 October 1991 signature of the European Economic Area (EEA) agreement by all 19 negotiating parties. Though ratification by signatories remains incomplete, little opposition should be expected. For more detail see Mark Maremont and Richard A. Melcher, "Tearing Down Even More Fences In Europe," *Business Week*, 4 November 1991, pp. 50-51.
95. Gary J. Schinasi, "European Integration, Exchange Rates, and Monetary Reform," *The World Economy*, December 1989, p. 391.
96. John Pinder, *European Community: The Building of a Union* (New York; Oxford University Press, 1991), p. 61.
97. Pinder, p. 63.
98. Jacobsen, p. 253.
99. Pinder, p. 115.
100. Pinder, p. 47-48.
101. Pinder, p. 149.
102. Pinder, p. 121-126, and Jacobsen, p. 257.
103. Currency unification under the ECU, currently planned for 1 January 1999, could be expected to save approximately \$25 billion a year for Europe through the prevention of unnecessary currency exchanges by both businesses and individuals.
104. Pinder, p. 91.
105. Pinder, p. 40.

106. Michael Calingaert, "Europe 1992: A Trading Bloc," in *The Growth of Regional Trading Blocs in the Global Economy*, eds. Richard S. Belous and Rebecca S. Hartley (Washington, D.C.: National Planning Association, 1990), p. 68.
107. Ibid, p. 69; for a similar discussion see Schinasi, p. 393.
108. Schinasi, p. 394.
109. Alan Riding, "Europeans accept a Single Currency and Bank by 1999," *The New York Times*, 10 December 1991, p. A1.
110. Anthony Rowley, "Europe's Single Challenge," *Far Eastern Economic Review*, 5 May 1988, p. 128.
111. Peter Holmes, "Economies of Scale, Expectations, and Europe 1992," *The World Economy*, December 1989, p. 525.
112. Craig R. Whitney, "Danes Reject Treaty on European Union," *The New York Times*, 3 June 1992, p.A1. Note: The negative Danish vote may have acted as an effective veto because the document specifically states that the treaty cannot go into effect in January 1993 unless unanimously ratified by all EC member states.
113. Alan Riding, "Europeans Face Future, Puzzling over Its Shape," *The New York Times*, 25 November 1991, p. A4.
114. Ibid.
115. Pinder, p. 17.
116. Ibid.
117. Trade figures of the IMF indicate that in 1963 intra-EC trade was less important than exports to the rest of the world. However by 1979, intra-EC trade was 20 percent higher than exports to the rest of the world. More recently, from 1985 to 1989, intra-EC trade rose from \$337 billion to \$678 billion (over a 100 percent increase) while exports to the rest of the world rose only by 46 percent (from \$313 billion to \$456 billion). For a more complete discussion, see Jeffrey J. Schott, "Trading Blocs and the World Trading System," *The World Economy*, March 1991, p. 4.
118. Michael Calingaert in *The Growth of Regional Trading Blocs in The Global Economy*, p. 75.
119. Whitney, p. A1.

120. It is important to remember, however, that NAFTA might well be expanded in the future to include other South American countries.
121. It is worthy of note that Canada and Mexico already conduct approximately two-thirds of their trade with the US and both benefit substantially from US Foreign Direct Investment (FDI) in their economies. See Jeffrey J. Schott, "Trading Blocs and the World Economy," p. 8.
122. Previously foreign ownership was limited to 49 percent. For further information see: Sidney Weintraub, *Free Trade Between the US and Mexico?* (Washington, D.C.: The Brookings Institution, 1984), p. 58.
123. Sectors included agriculture, investment, intellectual property, services, tariffs, and industry. For further information see: "United States-Mexico Economic Relations: Hearings Before the Subcommittee on Trade," *House Committee on Ways and Means* (Washington, D.C.: US Government Printing Office, 1990), p. 50.
124. Ibid, p. 104. Note: the framework agreement relatively quickly yielded further agreements in textiles, steel, and beer. See Jeffrey J. Schott, *More Free Trade Areas?*, p. 47.
125. Roger W. Wallace, "North American Free Trade Agreement: Generating Jobs for Americans," *Business America*, 8 April 1991, p.4. Note: even as early as 1987, Mexican exports to the US accounted for two-thirds of total exports. See Jeffrey J. Schott, *More Free Trade Areas?*, p. 46.
126. Larry Reibstein et. al., "A Mexican Miracle?," *Newsweek*, 20 May 1991, p. 44.
127. Jeffrey J. Schott, *More Free Trade Areas?*, p. 45; and Sidney Weintraub, "Free Trade in North America: Has its Time Come?," *The World Economy*, March 1991, p. 57
128. Maureen A. Farrow and Robert C. York, "Regional Trade and Trends: A North American View from the Inside Out," in *The Growth of Regional Trading Blocs in the Global Economy*, eds. Richard S. Belous and Rebecca S. Hartley (Washington, D.C.: The National Planning Association, 1990), p. 83.
129. Gary Clyde Hufbauer and Jeffery J. Schott, *North American Free Trade: Issues and Recommendations* (Washington, D.C.: Institute for International Economics, 1992), p. 3.
130. "US and Canada Trade Agreement," *1987 Congressional Quarterly Almanac*, p. 662.

131. Bentsen, leader of the powerful Senate Finance Committee and Rostenkowski, House Ways and Means Committee chairman are both by tradition and personality in powerful positions to influence trade debate. This was demonstrated aptly in the US-Canada free trade agreement debate and again in 1991 Fast Track legislation debate and can be expected again in the NAFTA debate. The fact that both are free trade area advocates should greatly help the NAFTA cause. See "US-Canada Free Trade Agreement Finalized," *1988 Congressional Quarterly Almanac*, p. 223. and David S. Cloud, "Hill Gives Bush Green Light To Negotiate Trade Pacts," *Congressional Quarterly*, 25 May 1991, pp. 1358-1359.
132. In passing through the Congress so quickly the US-Canada free trade agreement adhered to the letter (if not the spirit) of Fast Track regulations, negotiated under section 1103 of the 1988 Omnibus Trade Act. These regulations require that certain procedures be followed by Congress with respect to trade bills. Most importantly, such bills are given 90 days to pass through Congress once submitted and no amendments are authorized. In an action that certainly violated the spirit of Fast Track, if not its technical requirements, submission of the bill concerning the agreement was delayed in committee to allow a "shadow" markup and conference committee process, effectively circumventing the features of "fast track" legislation designed to speed trade agreements through Congress in 90 days. A similar action might be used in NAFTA negotiations to give Congress additional time to consider agreement ratification.
- Note: In a 1991 action seen, by many, as tacit endorsement by Congress for a free trade agreement with Mexico, Fast Track was extended until June 1993. For more information see Laura Gaughan, "Fast Track and Why We Need it for the NAFTA," *Business America*, 8 April 1991, p.6., Clyde H. Farnsworth, "Bush Trade Concessions Pick Up Some Support," *The New York Times*, 2 May 1991, Sec.C, p.2., and Keith Bradsher, Gephardt Backs Effort on Trade With Mexico," *The New York Times*, 10 May 1991, Sec.C, p. 2.
133. "US-Canada Free Trade Agreement Finalized," p. 228.
134. Wallace, p. 3.
135. Farrow and York in *The Growth of Regional Trading Blocs in The Global Economy*, p. 84.
136. Hufbauer and Schott, p. 20.
137. Clyde H. Farnsworth, "US-Canada Rifts Grow Over Trade," *The New York Times*, 18 February 1992, p. C1.

138. George W. Grayson, "Mexico Moves Toward Modernization," *Current History*, March 1991, p. 109.
139. William J. Holstein, "Inching Toward A North American Market," *Business Week*, 25 June 1990, p. 40.
140. "US and Mexico: A Partnership for Growth," *Business America*, 8 October 1990, pp. 2-61.
141. "Announcement by Presidents of US/Mexico/Canada on Free Trade Negotiations," *The New York Times*, 6 February 1991, Sec. D, p. 2.
142. Keith Bradsher, "Economic Accord Reached by US, Mexico and Canada to Lower Trade Barriers," *The New York Times*, 13 August 1992, p. A1.
143. Ibid. See also Keith Bradsher, "Headway on North American Trade Talks," *The New York Times*, 3 August 1992, p. C1.
144. William J. Holstein, Amy Borrus et. al., "Inching Toward A North American Market," *Business Week*, 25 June 1990, p. 40.
 Note: More specifically, opponents of the FTA are generally led by one of two groups. The first is organized labor. In America and Canada these groups normally base their opposition on fears of job losses as corporations move plants to Mexico to take advantage of cheaper labor. In the case of Mexico fears center on the specter of job-displacement to regions with higher levels of worker productivity in the north. The former, it is asserted, will cost jobs in Canada and the American midwest (where 30 percent of all jobs are in manufacturing and agriculture) while the latter will cost jobs in Mexico's cities.
 The second group consists of businessmen (chiefly Mexican and Canadian) in protected industries who fear exploitation of their "infant" industries. This group fears that small industry might be displaced by industrial giants (resulting in a loss of vital national productive capacity).
145. Ibid, p. 41.
146. Hufbauer and Schott, pp. 47-69.
147. Ibid.
148. Hufbauer and Schott, pp. 332-340.
149. See *North American Free Trade: Proceedings of a Conference* (Dallas: The Federal Reserve Bank of Dallas, 1991); Sidney Weintraub, "Free Trade in North America: Has its Time Come?," p.61; or Rene Villarreal and Rocio R. de

Villarreal, "The Supply Side Case for Free Trade With Mexico," *International Economic Insights*, March/April 1991, p. 17.

150. For more extensive analysis of these and other NAFTA economic issues see Sidney Weintraub, *Free Trade Between the US and Mexico?*, (Washington, D.C.: The Brookings Institution, 1984) or *US-Mexican Industrial Integration: The Road To Free Trade*, ed. Sidney Weintraub (Boulder: Westview Press, 1991)
151. David S. Cloud, "Bush's Action Plan May Be Key to Approval of Fast Track," *Congressional Quarterly*, 4 May 1991, p.1125. See also David S. Cloud, "Hill Gives Bush Green Light to Negotiate Trade Pacts," *Congressional Quarterly*, 25 May 1991, p. 1358.
152. Tim Golden, "An Outsider Nation at Last Arrived, Mexico Embraces the Trade Accord," *The New York Times*, 13 August 1992, p. C2.
153. See David E. Rosenbaum, "Next Comes the Political Review of the Free Trade Agreement," *The New York Times*, 12 August 1992, p.C4; and Clyde H. Farnsworth, "Mulroney's Task: Selling Trade Pact to Canadians," *The New York Times*, 13 August 1992, p. C2.
154. The agreement is not expected to come to a final vote under "Fast Track" rules until early next year. See Keith Bradsher, "President and Congress Square Off on North American Trade Accord," *The New York Times*, (September 1992, p. C2.
155. Farnsworth, "Mulroney's Task," p. C2.
156. Keith Bradsher, "President and Congress Square Off," p. C2.
Note: It is important to remember that funding for environmental cleanup and worker retraining programs can be increased without violating Fast Track procedural rules. This is likely to be used as a political tool by both parties in the negotiating process.
157. Ibid.
158. Auerbach and Cody, p. 7.
159. Auerbach and Cody, p. 7.
160. *US-Mexican Industrial Integration: The Road to Free Trade*, ed. Sidney Weintraub (Boulder: Westview Press, 1991), p. 49.

161. Other regional organizations are also increasingly important and cannot be ruled out as actors in regional integration schemes. Organizations such as the Asia Pacific Economic Cooperation (APEC) Forum, the Pacific Trade and Development Conference (PAFTAD), the Pacific Basin Economic Council (PBEC), the Pacific Economic Cooperation Conference (PECC), or the East Asian Economic Group/Council (EAEG or EAEC) may all play a role in the creation of an Asian FTA. In the author's opinion, the most likely scenario would involve a joint ASEAN/APEC or ASEAN/EAEC FTA process. However, because such an integrated process is not fully developed at this point, because ASEAN is the only organization that has taken concrete steps toward an Asian FTA, and because of space limitations, the other groupings are not considered in this document. For more information on these alternatives see Linda Low, "The East Asia Economic Grouping," and Andrew Elek, "The Challenge of Asian-Pacific Economic Cooperation," in, *The Pacific Review*, Vol. 4, No. 4, 1991.
162. The role of Japan is not extensively considered. This is because, though it is one of the three great single actors in international trading system, it does not appear that Japan is likely to take a direct and formal leadership role in any FTA now forming. This is not to say Japanese influence will remain minimal in a trading bloc system. Japan's indirect influence on ASEAN decisionmaking and policy (primarily through its financial presence in Asia) must not be minimized. It is this role *that will* be discussed due to its pertinence to the future of ASEAN.
163. Philip Shenon, "Southeast Asian Nations Sign Trade Accord," *The New York Times*, 29 January 1992, p. C1.
164. As compared to North American and EC growth rates averaging three percent or below.
165. The other two legs of the triad, of course, being the NAFTA and the EC.
166. Excerpt from "The Bangkok Declaration of ASEAN," as printed in Lawrence B. Krause, *US Economic Policy Toward the Association of Southeast Asian Nations* (Washington, D.C.: The Brookings Institution, 1982), p. 6.
167. Marcus Noland, *Pacific Basin Developing Countries: Prospects for the Future* (Washington, D.C.: The Institute For International Economics, 1990), p. 140.
168. Krause, p. 7.
169. Ibid.

Note: The summit also made provisions for a small permanent secretariat to be located in Jakarta, Indonesia.

170. Noland, p. 140.

171. Dean A. DeRosa, "Asian Preferences and the Gains from MFN Tariff Reductions," *The World Economy*, September 1988, p. 381.

172. Pangestu, Soesastro, and Ahmad, pp. 335-336.

Note: Both the above authors and Noland attribute the lack of intra-regional trade within ASEAN (16.3 percent of member states total trade in 1988) to various causes including a large number of products excepted and a lack of information (among others). However, it should be remembered that the types of exports from these countries were (and remain) similar in nature because of their similar production advantages (primarily low-cost labor and natural resource-intensive products). Since little difference in comparative advantage exists, there has been relatively little incentive for intra-regional trade. Further, intra-regional exports did increase dramatically during the early years of ASEAN (from less than \$1 billion in 1967 to \$8.9 billion by 1979 alone). Because of the similarity between economies further dramatic increases may not be realistic. Rather, gradual, incremental improvement should be seen. The Pangestu study validates this expectation. Thus, although tariff levels are no doubt important, they do not tell the whole story.

173. See Krause p. 12 or Noland, p. 141 for further discussion.

174. Currently only 18 products have been granted accreditation. For more detailed information see the recent study of ASEAN economic cooperation by Mari Pangestu, Hadi Soesastro, and Mubariq Ahmad, "A New Look at Intra-Asean Economic Co-operation," *ASEAN Economic Bulletin*, Vol.8, No. 3, pp. 337-338

175. Noland cites the success of cooperative ventures in areas covered by 11 permanent committees including: food and agriculture, shipping, civil air transport, communications/air traffic services/ meteorology, finance, commerce/industry, transport/telecommunications, tourism, science/technology, socio-cultural activities, and mass media. See Noland, p. 141.

176. Krause, p. 70.

177. Mohamed Ariff and Joseph L.H. Tan, *Introduction to the ASEAN Economic Bulletin*, Vol. 8, No. 3, p. 251.

178. Krause, p. 15.
179. "The Singapore Declaration of 1992," as printed in the *ASEAN Economic Bulletin*, Vol. 8, No. 3, p. 376.
180. Ibid, pp. 376-377.
Note: The fifteen product groups include vegetable oils, cement, chemicals, pharmaceutical, fertilizer, plastics, rubber products leather products, pulp, textiles, ceramic/glass products, gems/jewelry, copper cathodes, electronics, and wooden/rattan furniture.
181. It should be noted that both that NAFTA and the EC have exclusionary provisions that are somewhat similar to those specified in the AFTA declaration. Nevertheless, Malaysian economist Mohamed Ariff has argued that the success or failure of the AFTA may rest on the nature excluded products."Michael Vatikiotis, "Action at Last," *Far Eastern Economic Review*, 6 February 1992, p. 10.
182. For more details on trade similarities see Noland, pp. 129-138.
183. Linda Low, "The East Asian Economic Grouping," *Pacific Review*, Vol.4, No.4 (Oxford: Oxford University Press, 1991), p. 378.
184. 1986 to 1990 NIE investment in the "ASEAN four" countries (millions of US dollars):

	<u>From</u>	<u>To</u>
Indonesia	228	1,544
Malaysia	99	2,351
Philippines	8	189
Thailand		3883,391

Source: The International Center for the Study of East Asian Development, as quoted in Low, p. 378.
185. Studies indicate that factors in relocation are raw material availability and ease of access. Labor costs are a secondary factor. For more information see Pangestu, Soesastro, and Ahmad, p. 342.
186. Stephen W. Bosworth, "The United States and Asia," *Foreign Affairs*, Vol. 71, No. 1, Spring 1992, p. 122.
187. Based on statements of Thailand's Deputy Minister of Commerce, M.R. Pridiyathorn Devakula as quoted by Reynaldo A. De Dios, "Southeast Asian Insurance Regulation: Asean Members Striving to enhance Regional

Markets," *Business Insurance*, 6 January 1992, p. 11 and the Opening Address to the ASEAN Ministerial Meeting of Malaysian Prime Minister Dr. Mahathir Mohamad as quoted in the *Joint Communique of the Twenty-Fourth ASEAN Ministerial Meeting*, 19-20 July 1991, p. 46.

188. Jeffrey J. Schott, *More Free Trade Areas?*, p. 32.
189. Krause, p. 31.
190. Suetō Sudo, "Japan and the Security of Southeast Asia," *The Pacific Review*, Vol. 4, no. 4, 1992, p. 335.
191. Pangestu, Soesastro, and Ahmad, p. 340.
192. Japanese imports of NIE products and raw materials has simultaneously increased by 60 percent. Significantly, Japanese trade with East Asia has grown three times as fast as Japanese trade with the US since 1987. See Jeffrey J. Schott, "Trading Blocs and the World Trading System," p. 12.
193. Dick K. Nanto, "Asian Responses to the Growth of Trading Blocs," in *The Growth of Regional Trading Blocs in the Global Economy*, eds. Richard S. Belous and Rebecca S. Hartley (Washington, D.C.: National Planning Association, 1990), p. 100.
194. Nanto, p. 94. Note: the analogy of Japan as the leader of the flock of geese that makes up Asia has been often used.
195. Stuart Harris, "Varieties of Pacific Economic Cooperation," *The Pacific Review*, Vol. 4, No. 4, 1991, p. 307. See also Noland, p. 153.
196. Prime Minister Toshiki Kaifu, "Japan and ASEAN: Seeking A Mature Partnership for the New Age," Policy Speech delivered 3 May 1991 in Singapore, *ASEAN Economic Bulletin*, July 1991, p. 87.
197. Ariff and Tan, p. 251.
198. Ibid.
199. Nanto, p. 99.
200. Augusto de la Torre and Margaret R. Kelly, *Occasional Paper 93: Regional Trade Arrangements* (Washington, D.C.: International Monetary Fund, 1992), p. 3.
201. Ibid.

202. James Eggert, *Invitation to Economics*, 2nd ed. (Mountain View: Mayfield Publishing, 1991), p. 272.
203. Ibid.
204. The Heckscher-Ohlin-Samuelson model assigns more specific parameters to comparative advantage depending on national factor endowments of land, labor, and capital. These models come much closer to explaining the directions of trade flows and resulting potential gains than the simple model used here to explain basic concepts. For a more detailed discussion see Paul A. Samuelson, "The Gains From International Trade Once Again," in *International Trade: Selected Readings*, ed. Jagdish N. Bhagwati (Cambridge: MIT Press, 1981), pp. 131-141 or Root, pp. 67-92.
205. Paul Krugman, in fact argues that economies of scale and comparative advantage due to factor advantages are both sources of gains from trade. See Paul Krugman, *The Age of Diminished Expectations: U.S. Economic Policy in the 1990s* (Cambridge, MA: MIT Press, 1990), p. 74.
206. Even in situations where international factor endowments are the same and no other visible economies of scale exist, countries will continue to trade on an intra-industry basis. See Krugman, p. 38.
207. Samuelson, p. 139.
208. Kenneth W. Clements and Larry A. Sjaastad have succinctly argued that tariffs impose costs upon unprotected firms primarily via wage effects. They argue particularly that these costs fall hardest among exporters, making their products less competitive in the global trading system. See Kenneth W. Clements and Larry A. Sjaastad, *How Protection Taxes Exporters* (London: Trade Policy Research Centre, 1984).
209. Root, pp. 180-190.
210. See Jacob Viner, *The Customs Union Issue* (New York: The Carnegie Endowment, 1950).
211. Richard Lipsey, "The Theory of Customs Unions: A General Survey," in *International Trade: Selected Readings*, ed. Jagdish Bhagwati (Cambridge: MIT Press, 1981), p. 266.
212. Ali M. El-Agraa, "The Theory of Economic Integration," in *International Economic Integration*, ed. Ali M. El-Agraa (London: Macmillian Press, 1988), p. 17.

213. Paul Wonnacott and Mark Lutz, "Is There a Case for Free Trade Areas," in *Free Trade Areas and US Trade Policy*, ed. Jeffrey J. Schott (Washington, D.C.: Institute for International Economics, 1989), p. 62.
214. De la Torre and Kelly, p. 3.
215. Ibid.
Note: Some of the supply side effects of trade diversion may be offset by reduced costs of production in a member country.
216. Ibid.
217. Ibid.
Note: This effect works through declines in import purchases and declining export sales to non-union members.
218. Wonnacott and Lutz, p. 69. Note: Trade diversion is actually minimized where initial levels of external protection are either very high or very low. If external levels of protection were very high then few imports would be diverted. If external barriers were very low, imports from within the union would be only slightly more costly (at best) than those from outside the union. See De la Torre and Kelly, p. 4.
219. De la Torre and Kelly, p. 6.
220. Wonnacott and Lutz, p. 65.
221. See Augusto de la Torre and Margaret R. Kelly, *Regional Trade Arrangements* (Washington, D.C.: International Monetary Fund Occasional Paper 93, March 1992), p. 4.
222. This provides support for GATT Article 24 requirements which mandate that "substantially all trade" between union partners should be covered.
223. The difficulties associated with the measurement of trade creation and diversion should not be underestimated. Trends may be additionally exacerbated by "substitution effects." For a full exposition on the difficulties of integration effect measurement see; David G. Mayes, "The Problems of the Quantitative Estimation of Integration Effects," in *International Economic Integration*, ed. Ali M. Agraa (London: Macmillan Press: 1988), pp.42-58 or De la Torre and Kelly, p. 5; for discussion of substitution effects see Lipsey, p. 270-273.

224. Lipsey, p. 267.
Note: The optimum free trade conditions spoken of would be associated with so-called "Pareto" optimality, where the marginal costs and benefits of trade were in equilibrium.
225. Numerous articles chronicle growing global protectionist trends. See Jagdish N. Bhagwati, United States Trade Policy at the Crossroads, *The World Economy*, December 1989, p. 439 or John H. Jackson, "Consistency of Export-Restraint Arrangements with the GATT," *The World Economy*, December 1988, p. 485.
226. For a discussion of how protection taxes exports, see Clements and Sjaastad.
227. Though such a result is quite possible in the short term, it is likely that the damaged MNC would seek to move its production back inside its home country in the long run to decrease costs.
228. Wonnacott and Lutz, p. 69; also Lipsey, p. 267 and 277.
229. Though it appears on the surface to be somewhat simple, this is actually a highly complex and circular argument. For more information see Lipsey, p.268; Wonnacott and Lutz, p. 71; and H. Makower and G. Morton, "A Contribution Towards A Theory of Customs Unions," *Economic Journal*, Vol. 62 (1953), pp. 33-49.
230. Furthermore, intra-regional trade has increased in both the EC and EFTA as a result of initial union formation. Based on these measures, Wonnacott and Lutz conclude that trade creation has outweighed trade diversion. Also of note is a 1958 study from Holland. This study estimated the change in intra-European trade with a the reduction in tariffs between the six original common market countries, the UK, and Scandinavia. It found that intra-European trade could be expected to increase by approximately 17 percent. Lipsey's criticism of this analysis emphasized that 17 percent was a rather small increase given that the Benelux countries experienced a 50 percent increase in trade after the formation of their customs union. See: Wonnacott and Lutz, p. 78 and Lipsey, p. 278.
231. Holmes, p. 525.
232. See International Marketing Data and Statistics 1992, 16th ed., (London: Euromonitor, 1992).
233. Roger Porter, "Fortress Fears Unfounded," *Far Eastern Economic Review*, 21 November 1991, p. 27.

234. De la Torre and Kelly, p. 1.
235. See *International Marketing Data and Statistics 1992*.
236. All figures in this section are based on latest available years from 1985 to 1990 in *International Marketing Data and Statistics 1992* or *European Marketing Data and Statistics 1990*.
237. Brunei, with 98.5 percent of its exports in the first category clearly is an outlier. This probably reflects its relative lack of development. See *International Marketing Data and Statistics 1992*, p. 312.
238. De la Torre and Kelly, p. 5 and El-Agraa, pp. 27-28.
239. Wonnacott and Lutz, pp. 63-64.
240. De la Torre and Kelly, p. 5.
241. El-Agraa, p. 41.
242. Wonnacott and Lutz, p. 63.
243. El-Agraa, p. 30.
244. H.C. Petith, "European integration and the Terms of Trade," *Economic Journal*, vol. 87 (1977) as cited in El-Agraa, p. 30.
245. Significantly, this effect was originally formulated in terms of the more integrated economic and monetary systems expected to exist in a common market, such as that which may now be forming in the EC.
246. De la Torre and Kelly, p. 2.
247. Significantly, Kemp and Wan state that this theory "...contains no qualifications whatever concerning the size or number of the countries which are contemplating union, their pre- or post-union trading relationships, their relative states of development or levels of average income, and their propinquities in terms of geography or costs of transportation. See Maori Kemp and Henry Wan Jr., "An Elementary Proposition Concerning the Formation of Customs Unions," in *International Trade: Selected Readings*, ed. Jagdish Bhagwati (Cambridge: MIT Press, 1981), p. 283.

248. David Dollar, "Outward-Oriented Developing Economies Really Do Grow More Rapidly: Evidence From 95 LDCs, 1976-1985," *Economic Development and Cultural Change*, April 1992, p. 523.
249. De la Torre and Kelly, p. 4.
250. This argument might provide a clear mandate for international pressure on the EC to allow its member nations the flexibility to determine their own external tariff policies. In light of the continuing problems being encountered by the Maastricht Treaty Europe may be more, rather than less likely to liberalize this aspect of EC policymaking in the future.
251. See: Glenn W. Harrison and E.E. Rutstrom, "Trade Wars, Trade Negotiations, and Applied Game Theory," *Journal of the Royal Economic Society*, Vol.101 no. 406 (May 1991), p. 420.
252. This does not mean that American negotiators should cease to negotiate. Rather they must limit their concessions to those absolutely necessary to appear reasonable to the majority of GATT membership while attempting to maximize American advantage (with respect to the EC in particular). For a look at the outstanding issues in U.S.-EC negotiations, see: Keith Bradsher, "Progress Made in Talks With Europe on Trade," *The New York Times*, 3 November 1993, p. C1.
253. Note: A temporary solution that would save much face for GATT might lie in agreement by members to sign an interim agreement only on the issues where consensus has been reached. Divisive issues would be the subject of continuing negotiations under the banner of a new round which could be linked to the interim agreement so as to begin in January 1993.
254. The U.S. could further propose that this article be given true credibility by making strict compliance mandatory for all GATT members involved in regional arrangements. Though passage of such a requirement would be difficult in this consensus-based organization, it might be encouraged by emphasizing U.S. willingness to comply and by stressing the potential negative benefits of closed economic blocs on world trade. Smaller, non-FTA member nations might be expected to quickly rally to the American cause if such pressure was applied.
255. Many of GATT's current problems, which have their roots in sheer membership size and diversity, could, in this way, be reduced. In time, GATT might reassume its leading role as a results oriented trade management organization.

APPENDIX A: GATT ROUNDS SINCE WWII

SEVEN ROUNDS OF MULTILATERAL TRADE NEGOTIATIONS HAVE BEEN COMPLETED UNDER GATT AUSPICES SINCE WW II:

1. Geneva negotiations 1947 (45,000 tariff concessions)
2. Annecy negotiations 1949 (modest tariff reductions)
3. Torquay negotiations 1950-51 (reduced tariffs 25 percent from 1948 level)
4. Geneva negotiations 1955-56 (modest tariff reductions)
5. Geneva negotiations (Dillon round) 1959-62 (modest reductions)
6. Geneva negotiations (Kennedy round) 1963-67 (average tariff reductions-35 percent for industrial products, minimal reductions in agricultural products, anti-dumping code)
7. Geneva negotiations (Tokyo round) 1973-79 (average tariff reductions-34 percent for industrial products, non-tariff trade barrier codes)
8. Geneva negotiations (Uruguay round) September 1986-present

Source: "The Uruguay Round," *Finance and Development*, June 1991, p. 10.

APPENDIX B: GATT STRUCTURE

GATT Secretariat:

The GATT Secretariat is a relatively small group composed of national specialist representatives and trade professionals with an established reputation for "professionalism" and "efficiency." The group's mandate tasks it to promote "the preservation, enhancement, and enforcement of the rules of the existing trading order." Currently headed by long-time Director-General Arthur Dunkel, this body effectively and unobtrusively orchestrates GATT management, detection, and dispute settlement actions (including monitoring of injury claims and authorization of retaliation).

GATT Council:

The Council of Representatives was set up by the contracting parties in 1960 to replace the 1951 "Intercessional Committee" authorized to conduct mail or telegraphic voting between sessions. It meets every four to six weeks and consists of 49 representatives from governments "...willing to assume special responsibilities such as carrying out advisory work and recommending draft resolutions for mail or telegraphic approval by all the contracting parties." This staff also offers technical assistance and training programs world-wide. Like the Secretariat this body is known for dedicated professionalism in the execution of GATT policies.

GATT International Trade Center:

A sub-organization of the GATT, the International Trade Center, was established in 1964. This group has been jointly operated by the GATT and the UN Conference on Trade and Development since 1968. Its mission, to carry out activities in support of the trade promotion efforts of developing countries, is effectively performed through information and advisory services available to all developing countries.

Sources: Werner J. Feld and Robert S. Jordan with Leon Hurwitz, *International Organizations: A Comparative Approach*, 2nd ed., (New York: Prager Publishers, 1991), p.93.; David Pitt and Thomas C. Weiss eds., *The Nature of United Nations Bureaucracies* (Boulder: Westview Press, 1988), p.90.; Harold K. Jacobson, *Networks of Interdependence: International Organizations and the Global Political System*, 2nd ed., (New York: Alfred A. Knopf Inc., 1984), p. 261; and *Everyone's United Nations* (New York: UN Department of Public Information, 1986), p. 427.

APPENDIX C: GATT SUB-BODIES

CURRENT 20 SUB-BODIES UNDER GATT:

Committee on trade and development, Consultative Group of 18, Committee on Balance of Payment Restrictions, Committee on Budget-Finance and Administration, Committee of Participating Countries, Textiles Committee, Textiles surveillance Body, Committee on Tariff Concessions, Committee on Anti-Dumping Practices, Committee on Customs Valuation, Committee on Government Procurement, Committee on Import Licensing, Committee on Subsidies and Countervailing Measures, Committee on Technical Barriers to Trade, Committee on Trade in Civil Aircraft, International Meat Council, International Dairy Product Council, Committee on Safeguards, Committee on Trade in Agriculture, Group on Quantitative Restrictions and Other Measures.

Source: Everyone's United Nations (New York: United Nations Department of Public Information, 1986), p. 427.

APPENDIX D: EC MEMBERSHIP

Current EC membership includes: France, Germany, Italy, Belgium, the Netherlands, Luxembourg, Britain (1973), Denmark (1973), Ireland (1973), Greece (1981), Spain, and Portugal.

Non-EC members with applications pending: Malta, Turkey, Austria, Sweden, and Cyprus.

EFTA members expected to join the EC include: Sweden, Switzerland, Iceland, Norway, Finland, Austria, and Liechtenstein.

Associate members lobbying for full membership: Poland, Hungary, Czechoslovakia.

Source: Alan Riding, "West Europeans Gather to Seek a Tighter Union," *The New York Times*, 9 December 1991, p. A1.

APPENDIX E: MECHANICS OF THE U.S.-CANADA FREE TRADE AGREEMENT

General Provisions:

1. All tariffs to be eliminated immediately, or in equal annual reductions over five to ten years. (in practical application the agreement required a 10 year schedule for the elimination of steel and other critical tariffs with a 35 percent reduction occurring over five years and the remaining reductions spread over the rest of the period).
2. Some non-tariff barriers to trade in agriculture to be removed.
3. Both countries retain the right to use anti-dumping and countervailing duties against injurious subsidies or discriminatory pricing.
4. Further negotiation on government procurement to be undertaken not more than one year after renegotiation of GATT codes. (Actually negated the U.S. "Buy America" Act shortly after)

Other Provisions:

The agreement essentially eliminated most import/export restrictions between the two countries. Additionally, the agreement aligned product technical standards over 10 years, eliminated conditional import licenses for grains, eliminated transport subsidies for poultry and eggs, eliminated investment restrictions, implemented stricter intellectual property rights, and aligned laws on sales of services across the border.

Rules of origin were also addressed. These rules allow entry of goods that are wholly produced in the respective country, imported materials that have been

changed in commercially significant ways, or goods that have had over 50 percent of processing costs paid by either country.

In the area of dispute settlement procedures "snap back" provisions were included in the agreement that allow the reimposition of tariffs by either country on severely threatened goods within four days (to provide relief from unfair competition). More importantly, the agreement developed a dispute resolution/implementation commission with binding powers of arbitration. This feature, strongly supported by Canada and initially opposed by the U.S., prevented any trade disagreement from standing for an excessive length of time.

Sources: Charles R. Taylor, "North America: The New Competitive Space," *The Conference Board* (New York: The Conference Board Incorporated, 1991), pp.18-19.; Toni Dick, "Customs Procedures: Essentials for Exporting Under the CFTA," *Business America*, 8 April 1991, p.17.; and Jim Holbein, "U.S.-Canada FTA Dispute Settlement," *Business America*, 8 April 1991, p. 21.

APPENDIX F: THE NATIONAL OBJECTIVES OF THE FUTURE MEMBER STATES

Mexico:

Mexican objectives in the negotiations, according to Hufbauer and Schott, are twofold. First they hope to further secure market access to a North American market that accounts for three-quarters of their total exports. Second they hope to "lock in domestic institutional reforms instituted since 1985" in order to send positive signals to the international community that Mexican trade liberalization will continue. Further objectives include seeking to weaken U.S. anti-dumping/countervailing duty laws that protect American industry from competition, ensuring continued subsidy of certain relatively weak industries, assuring increased external capital inflow, improving the dispute settlement process, and participating in the U.S./Canada FTA "good deal."

Canada:

Canadian objectives in the NAFTA negotiations are somewhat less well defined. Essentially, they seem to include protection of its industry (particularly in its apparel, dairy, and poultry industries) from "unfair" competition and maintenance of wage standards. They are probably also participating out of a desire to retain both status/visibility in the world trading arena and to avoid a bilateral U.S.-Mexico agreement that leaves Canada with worse terms. For this

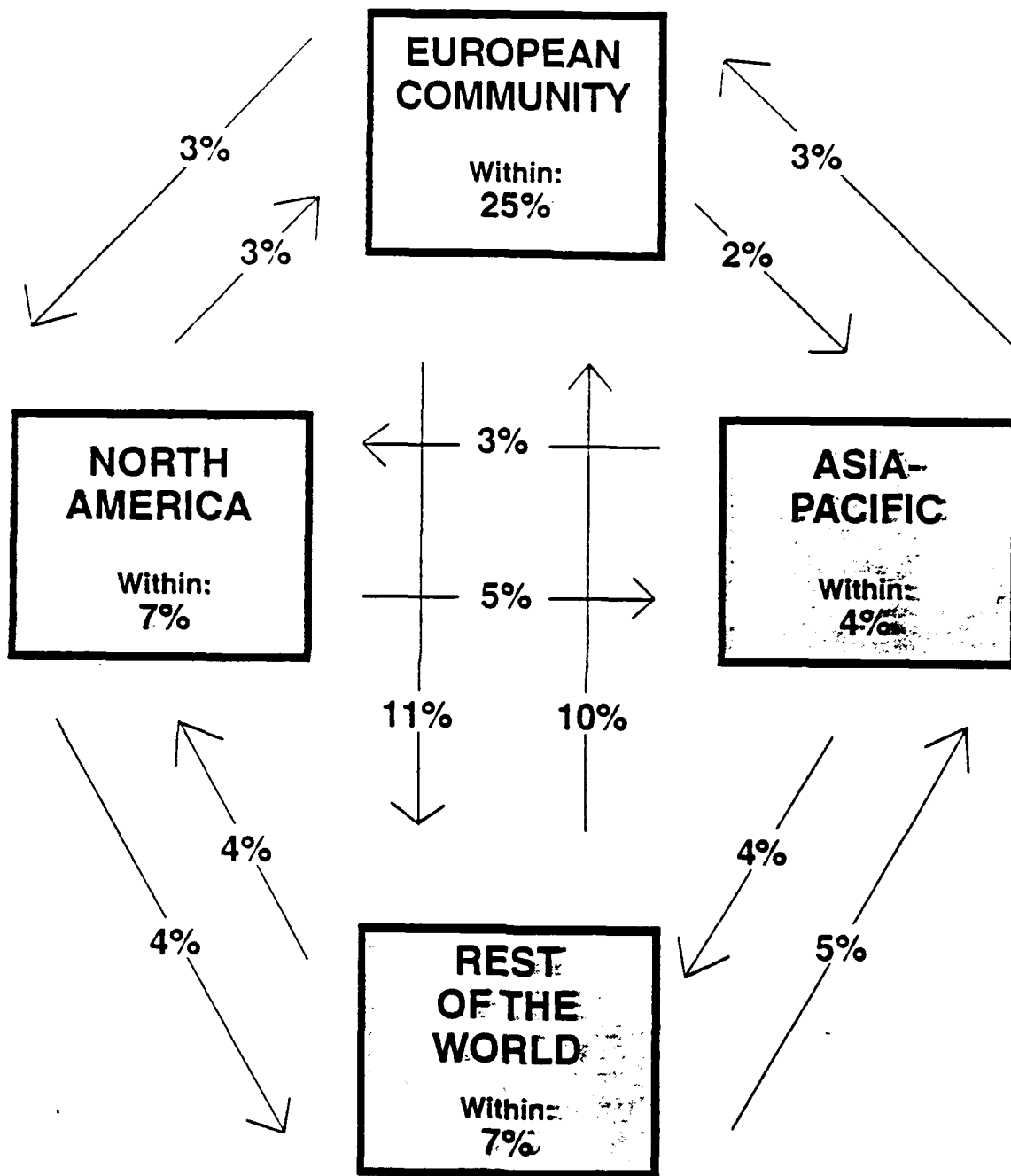
reason, Hufbauer and Schott appropriately term Canada the "reluctant partner in the NAFTA negotiations." Other items on the Canadian agenda may be more obscure. Regardless of their agenda, it is clear that Canada is playing a vital role as an arbitrator of U.S.-Mexican disputes during the negotiations process.

United States:

General American goals in the NAFTA process are centered in traditional pursuit of economic growth, increased economic efficiency, and the maintenance of North American political stability. More specifically, the U.S. is pursuing increased market access for consumer products, increased investment opportunities, and increased access to valuable Mexican resources (particularly oil) that can only be provided by free trade. Finally, America hopes for synergy-generated income and employment gains that will, according to Hufbauer and Schott, "...enhance the international competitiveness of firms throughout the region" and revitalize each country's export led growth aims.

Sources: Gary Clyde Hufbauer and Jeffrey J. Schott, *North American Free Trade: Issues and Recommendations* (Washington: Institute For International Economics, 1992), pp.10-22; David S. Cloud, "Congress Wary of Bush Plan to Open Doors to Mexico," *Congressional Quarterly*, 23 February 1991, p.454.; and Sidney Weintraub, *Free Trade Between the U.S. and Mexico?* (Washington: The Brookings Institution, 1984), pp. 143-147.

APPENDIX G: WORLD TRADE FLOWS



Source: 1991 United Nations World Economic Survey (New York: United Nations, 1991), p. 60.

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